

V. PARTIES RESPONSIBLE FOR VIOLATIONS OF LAW: PENSION

A. SDCERS

1. The SDCERS Board

An assessment of responsibility for illegal activity at SDCERS must start with the members of the Retirement Board. The Board was ultimately responsible for ensuring that SDCERS was in compliance with its fiduciary obligations to present and future retirees, as well as with all applicable laws and regulations.⁵⁸⁶ When it comes to MP-1 and MP-2, the Board failed to live up to its responsibility. By means of MP-1 and MP-2, the City was able to contribute to SDCERS at less than actuarially determined rates which, in conjunction with increased unfunded benefits and poor investment returns, caused SDCERS to become actuarially unsound.⁵⁸⁷ In so doing, MP-1 and MP-2 violated, among other things, the San Diego City Charter, the Municipal Code, and the California Constitution.

By voting for MP-1 and MP-2, the SDCERS Board breached its fiduciary duty to the Trust to act with the “care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.”⁵⁸⁸ The Board’s fiduciary duty to act in a prudent manner obligated it to investigate facts concerning the funding and maintenance of the system and to disclose that information to the beneficiaries of the system.⁵⁸⁹ Further, the Board had a duty to monitor investments and service providers, identify errors, and then act expeditiously to remedy them.⁵⁹⁰ As detailed above, the SDCERS Board failed in

⁵⁸⁶ Cal. Const. art. XVI, § 17.

⁵⁸⁷ Final Report, City of San Diego Pension Reform Committee at 11 (Sept. 15, 2004).

⁵⁸⁸ *Donovan v. Mazzola*, 716 F.2d 1226, 1231 (9th Cir. 1983) (applying “prudent man” rule as articulated by ERISA but noting that its articulation was based upon common law of trusts). The legal analysis accompanying the Navigant Report reached substantially the same conclusion, finding that, in agreeing to MP-1 and MP-2, the SDCERS Board breached its duty to act prudently in the administration of SDCERS and its duty of loyalty to the members of SDCERS. Reish Luftman Reicher & Cohen, Legal Analysis of Investigative Report on the San Diego City Employees’ Retirement System at 79, 94-96 (Jan. 20, 2006). City Attorney Interim Report No. 6 reached much the same conclusion as to the SDCERS Board’s approval of MP-1, as did City Attorney Interim Report No. 2 to the SDCERS Board’s approval of MP-2. City Attorney Michael J. Aguirre, Amended Interim Report No. 6 Regarding the San Diego City Employees’ Retirement System Funding Scheme at 35 (July 1, 2005); City Attorney Michael J. Aguirre, Interim Report No. 2 Regarding Possible Abuse, Illegal Acts or Fraud by City of San Diego City Officials at 97-99 (Feb. 9, 2005).

⁵⁸⁹ *Barker v. American Mobil Power Corp.*, 64 F.3d 1397, 1403 (9th Cir. 1995); *City of Oakland v. Public Employees’ Retirement Systems*, 95 Cal. App. 4th 29, 40 (2002).

⁵⁹⁰ *Morrissey v. Curran*, 567 F.2d 546, 548-49 (2d Cir. 1997); 29 C.F.R. § 2509.9601(c) (2006). Although *Morrissey* was based on a violation of ERISA, this body of law may be instructive regarding the fiduciary duties of the SDCERS Board. ERISA primarily governs private employee benefit plans maintained by employers or employees engaged in commercial activities and does not apply to governmental plans, such as SDCERS. 29 U.S.C. § 1003(a)-(b). However, given the similarities between the standards enunciated in Cal. Const. art. XVI, § 17 and those contained in

each of these duties: the Board failed to investigate the relevant facts related to the consequences of its acquiescence to two illegal funding plans; the Board failed to adequately educate plan beneficiaries of the consequences of the underfunding; and it failed to act expeditiously to correct any of the errors – related to, among other things, MP-1, MP-2, or the underpricing of Purchase of Service Credits – upon discovery.⁵⁹¹

The Board also violated Article XVI, Section 17 of the California Constitution, which required members of the Board to “discharge their duties with respect to the system solely in the interests of, and for the exclusive purpose of providing benefits to, participants and their beneficiaries” and that “a retirement board’s duty to its participants and their beneficiaries shall take precedence over any other duty.”⁵⁹²

To be fair, the Board is not solely responsible for MP-1 and MP-2. It sought the advice of outside professionals, both actuarial and legal. It also relied upon a staff of full-time professional employees, including an administrative staff and internal general counsel (for MP-2), to bring to its attention legal or actuarial problems with MP-1 and MP-2. These individuals, insofar as they failed to render unbiased, professionally competent advice or otherwise turned a blind eye to facts indicating that MP-1 and MP-2 were harmful to SDCERS or were in violation of California law, also bear responsibility for the Board’s fiduciary breaches, as discussed below. But even if the professionals did not do their job, that does not absolve the Board of responsibility for its own conduct. Although the Board could look to professionals for advice, it had to make its own independent judgment about what was in the best interests of SDCERS, without regard to individual interests of Board members or the competing interests of other constituencies.⁵⁹³ The Board failed to do this.

ERISA, the fiduciary principles embodied in ERISA shed light on the responsibilities of the SDCERS Board members. 29 C.F.R. § 2550.404a-1 (2006); Cal. Const. art. XVI, § 17. In a memorandum by the City Attorney, a Board’s fiduciary duty of prudence under article XVI, section 17 of the California Constitution was equated with the “prudent person” standard defining “a fiduciary’s duties and responsibilities to an employee benefit plan governed by the Employee Retirement Income Security Act of 1974 [ERISA].” The City Attorney concluded that while a City’s employee benefit plan is a government plan and thus the provisions of ERISA do not apply, “it is likely a court would use the ‘prudent person’ standard as it has been interpreted for employee benefit plans governed by ERISA in determining [a Board’s] fiduciary duty.” Memorandum from City Attorney to SPSP/401(K) Trustee Board (Aug. 12, 2004). Therefore, the law of ERISA provides a legal framework for understanding the fiduciary duties of the Board.

⁵⁹¹ City Attorney Michael J. Aguirre has alleged that Mr. Saathoff was instrumental in the decision to refer the purchase of service price setting responsibility to a SDCERS subcommittee – pricing which, as alleged by Mr. Aguirre, was discounted and not based on sound actuarial principles. Second Amended Complaint at 30-33, *People v. Grissom*, No. GIC 850246 (Cal. Super. Ct. Dec. 12, 2005).

⁵⁹² The legal analysis accompanying the Navigant Report similarly concluded that the SDCERS Board violated these tenets of the California Constitution by agreeing to MP-1 and MP-2. Reish Luftman Reicher & Cohen, *Legal Analysis of Investigative Report on the San Diego City Employees’ Retirement System* at 79, 93-94 (Jan. 20, 2006). The City Attorney reached a similar conclusion with regard to both MP-1 and MP-2. City Attorney Michael J. Aguirre, Amended Interim Report No. 6 Regarding the San Diego City Employees’ Retirement System Funding Scheme at 33 (July 1, 2005); City Attorney Michael J. Aguirre, Interim Report No. 2 Regarding Possible Abuse, Illegal Acts or Fraud by City of San Diego Officials at 97-99 (Feb. 9, 2005).

⁵⁹³ Cal. Const. art. XVI, § 17(b).

Moreover, when the Board's professional advisors cautioned against certain actions as unwise, unsound, or illegal, the Board frequently ignored them and did the wrong thing anyway. For example, the Board was cautioned by its actuary, Rick Roeder, that the "contingent" *Corbett* liabilities were not truly contingent and would decrease the funded ratio.⁵⁹⁴ The Board's fiduciary counsel, Constance Hiatt, also advised the Board that the "contingent" *Corbett* liabilities were contingent in name only.⁵⁹⁵ Notwithstanding this advice, the Board directed its actuary not to include the *Corbett* liabilities in SDCERS's UAAL, for the sole reason that, by excluding these liabilities, SDCERS would be able to report an inflated funded ratio and the City would be able to record a lower NPO.⁵⁹⁶ This decision benefited the City to the detriment of SDCERS. At a minimum, the Board's intentional decision to understate SDCERS's UAAL breached its fiduciary duty to SDCERS.

Similarly, the Board's conduct when seeking legal advice with respect to MP-1 undermines any confidence that they would have gained from that advice. First, it appears that, in dismissing Morrison & Foerster, its previous counsel, the Board was silencing a potentially dissenting voice, given Morrison & Foerster's lack of receptivity to prior efforts by the City to obtain contribution relief.⁵⁹⁷ More significant, however, was the failure of the Board to seek advice as to the most significant legal issue facing the Board in connection with MP-1, namely its legality. It does not appear fiduciary counsel was even asked to address the legality of MP-1 under the San Diego City Charter, Municipal Code, or the California Constitution.⁵⁹⁸

The situation was even worse when it came to MP-2. There, the evidence suggests the Board's fiduciary counsel, Robert Blum and Constance Hiatt, did not exercise their independent legal judgment at all, but instead took direction from SDCERS Administrator Grissom in advising the Board against MP-2 and, later, reversing course and advising the Board in favor of it.⁵⁹⁹ And, unlike MP-1, where the Board's actuary actively supported the measure during Board meetings at which it was discussed,

⁵⁹⁴ Minutes, SDCERS Board Meeting at 11, 13 (June 21, 2002); Letter from Rick A. Roeder to Larry Grissom (Mar. 30, 2000).

⁵⁹⁵ Letter from Constance M. Hiatt to Loraine E. Chapin, Esq. cc to Lawrence B. Grissom and Robert A. Blum (Apr. 16, 2002).

⁵⁹⁶ E-mail from Robert Blum to Larry Grissom cc to Connie M. Hiatt (July 3, 2002); Minutes, SDCERS Board Meeting at 13 (June 21, 2002).

⁵⁹⁷ Letter from Morrison & Foerster to Lawrence B. Grissom, Retirement Administrator (May 9, 1995).

⁵⁹⁸ Rather, fiduciary counsel was asked only to provide an opinion as to whether the SDCERS Board would be discharging its fiduciary duties to SDCERS by approving MP-1. Letter from Dwight Alan Hamilton, Hamilton and Faatz, and John A. Graham, Frandzel & Share, to Lawrence B. Grissom, Retirement Administrator (June 21, 1996).

⁵⁹⁹ E-mail from Sheila Leone to Loraine Chapin (Mar. 24, 2003); Letter from Bob Blum and Connie Hiatt to Frederick W. Pierce, President, Retirement Board (Nov. 18, 2002); Letter from Constance M. Hiatt and Robert Blum to Lawrence Grissom, Retirement Administrator (Draft June 12, 2002).

SDCERS's actuary actually resisted MP-2.⁶⁰⁰ In fact, had any of the Board members cared enough to ask Mr. Roeder for his honest assessment of MP-2, they would have learned as much.⁶⁰¹ As it turned out, only one Board member – Diann Shipione – did so.⁶⁰² This failure to seek guidance on the fiscal propriety of MP-2 from the one person most qualified to give it (actuary Rick Roeder) evidences the Board's abandonment or disregard of its obligation to the retirement system and its beneficiaries. Finally, the insistence by the SDCERS Board that the City indemnify it as a condition of its approval of MP-2 underscores the Board's concern – one they failed properly to address or resolve – that what it was doing may have been illegal or a breach of its fiduciary duty.⁶⁰³ Indeed, Ms. Shipione asked fiduciary counsel Bob Blum at the June 21, 2002 Board meeting how the Board could be indemnified knowing it had breached its fiduciary duty.⁶⁰⁴ Then, less than six months after the adoption of MP-2, the Board's new outside counsel advised it that MP-2 was illegal and the Board should blame its adoption on pressure from the City.⁶⁰⁵ The Board either knew, or should have known, that its conduct was at best improper and at worst illegal.

The following Retirement Board members voted for MP-1 on June 21, 1996: Keith Enerson, Bruce Herring, Sharon Wilkinson, Terri Webster, Robert Scannell, Ron Saathoff, John Torres, and Conny Jamison.⁶⁰⁶ Each of these individuals, in voting to approve MP-1, breached their fiduciary duties to

⁶⁰⁰ Letter from Rick Roeder, Fellow of the Society of Actuaries, to Councilman Scott Peters (Aug. 12, 2004); Letter from Reg A. Vitek, Seltzer Caplan McMahon Vitek, to Sheila Leone, Esq. cc to Michael A. Leone, Esq. (Mar. 5, 2003); Letter from Rick A. Roeder to Larry Grissom, Retirement Administrator (Nov. 5, 2002); Minutes, SDCERS Board Meeting at 28 (June 21, 1996); Minutes, SDCERS' Retirement Board of Administration Special Workshop at 15 (June 11, 1996).

⁶⁰¹ Letter from Rick Roeder, Fellow of the Society of Actuaries, to Councilman Scott Peters (Aug. 12, 2004); Letter from Reg A. Vitek, Seltzer Caplan McMahon Vitek, to Sheila Leone, Esq. cc to Michael A. Leone, Esq. (Mar. 5, 2003); Letter from Rick A. Roeder to Larry Grissom, Retirement Board Administrator (Nov. 5, 2002); E-mail from Constance Hiatt to Lawrence Grissom cc to Bob Blum (July 18, 2002).

⁶⁰² E-mail from Constance Hiatt to Lawrence Grissom cc to Bob Blum (July 18, 2002) (in which Ms. Hiatt discussed Mr. Roeder's conversation with Ms. Shipione regarding the modified MP-2 proposal adopted by the Board on July 11, 2002, noting that Mr. Roeder "spoke 'candidly' with Diane [sic], not only as an actuary and suggested if she were sufficiently outraged, she and other likeminded board members should wage a campaign to have voters approve all benefit increases as they do in SF."). Mr. Roeder testified that he may have spoken to Ms. Shipione and he would have likely explained that, although MP-2 did not represent a best practices approach, the plan in the long run would not have necessarily precluded the System from reaching a funded ratio near 100%. Transcript of Preliminary Hearing at 1232, 1235, *People v. Lexin*, No. CD 190930 (Cal. Super. Ct. Dec. 7, 2005).

⁶⁰³ Minutes, SDCERS Board Meeting at 22 (Nov. 15, 2002); Minutes, SDCERS Board Meeting at 28-29 (July 11, 2002); Minutes, SDCERS Board Meeting at 26-27 (June 21, 2002); E-mail from Robert Blum to Loraine Chapin, Lawrence Grissom and Paul Barnett cc to Connie M. Hiatt (July 15, 2002).

⁶⁰⁴ Minutes, SDCERS Board Meeting at 26 (June 21, 2002).

⁶⁰⁵ Letter from Reg A. Vitek, Seltzer Caplan McMahon Vitek, to Sheila Leone, Esq. cc to Michael A. Leone, Esq. (Mar. 5, 2003).

⁶⁰⁶ Minutes, SDCERS Board Meeting at 31 (June 21, 1996). SDCERS Board members Jack Katz, Ann Parode, and Paul Barnett voted against the proposal.

SDCERS for all of the reasons set forth above. Likewise, the Board members who voted for MP-2 on July 11, 2002 – Ronald Saathoff, John Casey, Mary Vattimo, Frederick Pierce, Sharon Wilkinson, John Torres, Cathy Lexin, and Terri Webster – also breached their fiduciary duties to the SDCERS Trust.⁶⁰⁷

In addition to breaches of fiduciary duty, the SDCERS Board's approval of MP-1 and MP-2 also implicated California's conflict of interest laws. When the Board voted to approve the funding arrangements embodied in MP-1 and MP-2, on which the retirement benefits negotiated between the City and the labor unions were "contingent," the Board essentially wielded "veto" power over those benefits. As a result, the Board members who were also pension plan participants (*i.e.*, City employees) voted to approve a contract in which they held a financial interest – namely, their own enhanced pension benefits.⁶⁰⁸

California Government Code Section 1090 ("Section 1090") prohibits a public official from entering into a contract, in his official capacity, in which he has a financial interest.⁶⁰⁹ Section 1090 contains a "salary exemption," which provides that benefits constituting "salary" will not be considered "disqualifying financial interests" when they are disclosed to the rest of the decision-making body, noted in that body's official record, and the contract is approved without counting the votes of the interested members.⁶¹⁰ Even if enhanced pension benefits are considered "salary," this exemption is unavailable to the conflicted members of the SDCERS Board because their financial interests were not disclosed in the manner required by Section 1090, and they participated in the Board votes to approve MP-1 and MP-2. The "rule of necessity," which permits public officials to enter into contracts which may otherwise be within the ambit of conflict of interest laws when the application of such laws would impede the vital public duties of a decision-making body, does

⁶⁰⁷ Minutes, SDCERS Board Meeting at 38 (July 11, 2002). For the July 11, 2002 vote, Ray Garnica abstained, Tom Rhodes and David Crow voted no, and Richard Vortmann and Diann Shipione were not present. Minutes, SDCERS Board Meeting at 38 (July 11, 2002). For the November 15, 2002 vote, Diann Shipione and Tom Rhodes voted no and Cathy Lexin was not present. Minutes, SDCERS Board Meeting at 30 (Nov. 15, 2002).

Cathy Lexin, Ron Saathoff, John Torres, Mary Vattimo, Terri Webster, and Sharon Wilkinson have argued that the July 11, 2002 vote for MP-2 did not constitute an agreement with the City because the Board was completely free to withdraw from MP-2 if a final written contract could not be agreed upon or if its fiduciary counsel or actuary later disapproved of it. Memorandum of Points and Authorities in Support of Motion to Set Aside Information Pursuant to Penal Code Section 995, *People v. Lexin*, No. SCD 190930, at 52-55 (Cal. Super. Ct. June 30, 2006).

⁶⁰⁸ In late July, after Ms. Lexin had already voted for the proposal at the July 11, 2002 SDCERS Board meeting, Mr. Blum noticed that the possibility existed that Ms. Lexin was conflicted because she was currently negotiating the agreement that she was voting on as a Board member. E-mail from Robert Blum to Lawrence Grissom, Paul Barnett and Loraine Chapin cc to Connie M. Hiatt and Marcus Wu (July 30, 2002). In the end, Ms. Lexin did not participate in the vote regarding MP-2 at the November 15, 2002 SDCERS Board meeting. Minutes, SDCERS Board Meeting at 30 (Nov. 15, 2002).

⁶⁰⁹ Cal. Gov't Code § 1090 (Deering 2006).

⁶¹⁰ Cal. Gov't Code § 1091(b)(13) (Deering 2006).

not insulate the SDCERS Board's actions.⁶¹¹ While the Board was required to enter into funding agreements with the City in order to fulfill its administrative duties, it was *not* required to accept these particular funding agreements which improperly tied increased benefits to contribution relief.⁶¹² Thus, the SDCERS Board violated Section 1090 by approving MP-1 and MP-2.⁶¹³

⁶¹¹ Cal. Gov't Code § 87101; *Finnegan v. Schrader*, 91 Cal. App. 4th 572, 582-583 (Cal. Ct. App. 2001) ("If the board has a legal duty to enter into a particular contract in which one of its members has a financial interest, the rule of necessity may come into play.").

In an action brought by the State of California against Cathy Lexin, Ron Saathoff, John Torres, Mary Vattimo, Terri Webster, and Sharon Wilkinson, the presiding judge found during a preliminary hearing that there was probable cause to believe that those defendants violated Section 1090. The judge stated that the Rule of Necessity did not apply in that case because the defendants did not have a duty to act. He explained that the SDCERS Board's duties did not include voting on the setting of salaries or pension benefits. Reporter's Preliminary Hearing Transcript, *People v. Lexin*, No. 190930, at 2581 (Cal. Super. Ct. Jan. 13, 2006).

⁶¹² See *Finnegan v. Schrader*, 91 Cal. App. 4th 572, 582-583 (Cal. Ct. App. 2001).

⁶¹³ Apparently, however, City Attorney Casey Gwinn advised the City Council in 2003 that it was not a violation of Section 1090 or the Political Reform Act to vote on retirement benefits. Councilmember Peters and Former Mayor Murphy's Memorandum of Points and Authorities in Support of Motion to Disqualify the City Attorney, To Quash Subpoenas and for a Protective Order, *San Diego Employees' Ret. Sys. v. Aguirre*, No. GIC 841845, at 4 (Cal. Super. Ct. Apr. 24, 2006).

Cathy Lexin, Ron Saathoff, John Torres, Mary Vattimo, Terri Webster, and Sharon Wilkinson have argued that they did not violate Section 1090 by voting for MP-2 because retirement benefits are part of a public official's salary, the California Constitution required members of the SDCERS Board to consider benefits to members as part of their fiduciary duties, the Charter required them to sit on the Board and make decisions which entailed conflicts of interests, and they had no financial interest in MP-2. They have also stated that neither Mr. Blum, the City Attorney's Office nor any other counsel ever told any Board member that they would be violating Section 1090 by voting on MP-2. Memorandum of Points and Authorities in Support of Motion to Set Aside Information Pursuant to Penal Code Section 995, *People v. Lexin*, No. SCD 190930, at 12, 55-57, 64-77, 82 (Cal. Super. Ct. June 30, 2006). However, the presiding judge found during a preliminary hearing that there was probable cause to believe that those defendants violated Section 1090 when they voted for MP-2. The judge explained that the defendants agreed to the City's contribution relief in exchange for increased personal benefits. He stated:

It's like they did everything that they could to give the relief here. The interesting thing is why. Why? The carrot was the contingency. . . . [A]t meet-and-confer it was said that these benefits are contingent. They knew that. There were folks on the Board that were a part of the meet-and-confer process and they knew that these benefits were contingent upon the Board's relief. In other words, the City did not want to pay that big balloon payment. . . . Why are [the defendants] going through this? It's like they are so hot to get this rate relief for the City. What's the reason for it? . . . And the big word that keeps jumping up here is contingent, contingent, contingent. It was contingent in May, it was contingent in June, it was contingent in July. And as Mr. Ewell said, the rate increases were "always" contingent upon rate relief. . . . They were financially interested in this agreement because it increased their pension benefits.

The Court noted that the defendants had "significant" defenses to the charges of Section 1090 violations, but that those defenses could not obliterate the elements of such a violation at the preliminary hearing stage. Reporter's Preliminary Hearing Transcript, *People v. Lexin*, No. SCD 190930, at 2575-2577 (Cal. Super. Ct. Jan. 13, 2006).

In its 2005 Report, Vinson & Elkins mentioned potential conflict of interest issues under Section 1090 with regards to the Board's approval of MP-1 and MP-2, but did not reach a conclusion on this issue. Paul S. Maco & Richard C. Sauer, Vinson & Elkins LLP, Potential Violations of the Federal Securities Laws by the City of San Diego and Associated Individuals at 29-31, 70-73 (Draft July 15, 2005).

The Political Reform Act (“PRA”) also prohibits public officials from entering into contracts in which they have a financial interest.⁶¹⁴ In contrast to Section 1090, under the PRA, a public official has a disqualifying financial interest only if he would receive a benefit from the contract that is distinguishable from the benefits received by the public generally.⁶¹⁵ It is therefore likely the PRA would not apply to the actions of those Board members who received the same pension benefit increases as other plan participants. At the very least, however, the Presidential Leave benefits contained in MP-2 were not shared with the plan participants generally as they only impacted three union presidents.⁶¹⁶

In his Interim Report No. 3, City Attorney Aguirre concluded that, with regards to Section 1090, MP-1, and MP-2 “were carried out in a manner contrary to law.” City Attorney Michael J. Aguirre, Interim Report No. 3 Regarding Violations of State and Local Laws as Related to the SDCERS Pension Fund at 14 (Apr. 9, 2005). In a civil action, City Attorney Aguirre has alleged that Lawrence Grissom, Ron Saathoff, John Torres, Sharon Wilkinson, Terri Webster, Cathy Lexin, Bruce Herring, and Loraine Chapin had conflicts of interest when they participated in or influenced the decisions leading to MP-1 and MP-2. Those decisions, according to Mr. Aguirre, placed the defendants in an advantageous position to receive, among other things, a greater percentage share of the SDCERS pension funds than other pension participants. Second Amended Complaint, *People v. Grissom*, No. GIC 850246, at 1-6 (Cal. Super. Ct. Dec. 12, 2005). Mr. Aguirre raised similar allegations in a cross-complaint against SDCERS that the implementation of MP-1 and MP-2 enhanced the pension benefits for former Board members Ron Saathoff, John Torres, Mary Vattimo, Terri Webster, and Sharon Wilkinson in violation of California Government Code § 1090. Third Amended Cross Complaint, *San Diego City Employees’ Ret. Sys. v. Aguirre*, No. GIC 841845 (Cal. Super. Ct. Jan. 27, 2005).

⁶¹⁴ Cal. Gov’t Code § 81000 *et seq.*

⁶¹⁵ Cal. Gov’t Code § 87103.

⁶¹⁶ In its 2005 Report, Vinson & Elkins mentioned potential conflict of interest issues under the PRA with regards to the Board’s approval of MP-1 and MP-2, but did not reach a conclusion on this issue. Paul S. Maco & Richard C. Sauer, Vinson & Elkins LLP, Potential Violations of the Federal Securities Laws by the City of San Diego and Associated Individuals at 29-31, 70-73 (Draft July 15, 2005).

In his Interim Report No. 3, City Attorney Aguirre concluded that “[t]aken as a whole, the PRA was not followed.” City Attorney Michael J. Aguirre, Interim Report No. 3 Regarding Violations of State and Local Laws as Related to the SDCERS Pension Fund at 16 (Apr. 9, 2005). This Report stated that “it can be argued that a material financial interest would not exist under the PRA because the financial interest felt by the general members of the Board would be equally felt by a large number of other City employees,” but nonetheless found that the PRA’s salary exception “was not designed to cover to [sic] the egregious and flagrant self-dealing seen here and would not likely apply.” *Id.* at 16. This Report also found that the Presidential Leave benefits conferred upon Ronald Saathoff “were anything but ordinary, and did not affect a large group.” *Id.* Similarly, Terri Webster was one of only approximately 300 plan participants who benefited from a provision in the MP-2 benefit enhancements allowing employees who joined the City before age 24 to be “grandfathered” and thereby excluded from the cap which restricted an individual’s pension benefits. We believe this benefit was not “shared by the public generally,” and therefore Ms. Webster violated the PRA in voting to approve MP-2. City Attorney Aguirre also concluded that this benefit was not shared by the public generally, and was therefore a disqualifying interest under the PRA. City Attorney Michael J. Aguirre, Interim Report No. 3 Regarding Violations of State and Local Laws as Related to the SDCERS Pension Fund at 15-16 (Apr. 9, 2005). City Attorney Aguirre advanced these and other conclusions in a lawsuit brought on behalf of the City of San Diego against Council members Michael Zucchet and Ralph Inzunza and former Mayor Richard Murphy. The City claimed that some or all of the defendants had violated Section 1090 and the PRA by, among other things, modifying the Legislative Officers’ Retirement Plan (“LORP”) and the Elected Officer’s Retirement Plan (“EORP”). However, the case was voluntarily dismissed by the City Attorney, without prejudice, after the presiding justice stated at a hearing that Mayor Murphy and Council members Zucchet and Inzunza were improperly named as defendants. The Court explained that the named defendants did not modify the Municipal Code and individual Council members had no legal authority to bind the City by adopting an ordinance. Judgment of Dismissal and Award of

While it is difficult to assign degrees of responsibility among the various Board members insofar as their actions as Board members are concerned, Mr. Saathoff's backing of MP-2 stands out as being particularly egregious. As the President of the Firefighters' Union, the longest serving member on the SDCERS Board, and the most prominent of the union elected Board members, Mr. Saathoff was viewed by the City officials as critical to gaining SDCERS's support of MP-2 – especially in light of the fact that SDCERS's professional advisors were opposed.⁶¹⁷ It appears the City effectively “bought” Mr. Saathoff's support for MP-2 by providing him with the generous Presidential Leave benefit enhancement package that increased his yearly pension benefit, upon his retirement or participation in the Deferred Retirement Option Program,⁶¹⁸ by approximately \$30,000 annually.⁶¹⁹ In accepting this unique financial benefit, Ron Saathoff violated the PRA by voting to approve MP-2.

Costs, *City of San Diego v. Murphy*, No. GIC 854373 (Cal. Super. Ct. Mar. 27, 2006); Plaintiff's Supplemental Brief, *City of San Diego v. Murphy*, No. GIC 854373 (Cal. Super. Ct. Sept. 23, 2005); Complaint, *City of San Diego v. Murphy*, No. GIC 854373 (Cal. Super. Ct. Jan. 3, 2006). Nevertheless, in another lawsuit brought by City Attorney Aguirre and the City against SDCERS, the City moved for summary judgment for, among other things, a declaration that the retirement benefits created under LORP and EORP violated Section 1090, the City Charter, and the California Constitution. The City's motion was denied on technical grounds. Some City officials have moved to disqualify the City Attorney from this case because they allege that City Council never gave the City Attorney permission to file it on the City's behalf. Defendants and Cross-complainants San Diego City Attorney Michael J. Aguirre and the City of San Diego's Memorandum of Points and Authorities in Support of Motion For Summary Judgment, or in the Alternative, Summary Adjudication of the Issues, Councilmember Peters and Former Mayor Murphy's Memorandum of Points and Authorities in Support of Motion to Disqualify the City Attorney, To Quash Subpoenas and for a Protective Order, *San Diego Employees' Ret. Sys. v. Aguirre*, No. GIC 841845, at 8-27 (Cal. Super. Ct. Apr. 24, 2006).

⁶¹⁷ Presidential Retirement Agreement Between the City of San Diego and Ron Saathoff, President of the San Diego City Firefighters, Local 145 (Dec. 12, 2003); Letter from Rick A. Roeder to Larry Grissom, Retirement Administrator (Nov. 5, 2002); Letter from Constance M. Hiatt and Robert Blum to Lawrence Grissom, Retirement Administrator (Draft June 12, 2002); E-mail from Terri Webster to Dan Kelley (May 21, 2002); E-mail from Terri Webster to Ed Ryan, Mary Vattimo and Cathy Lexin cc to Bruce Herring (Feb. 28, 2002); Interview by the Audit Committee with Richard Vortmann (May 1, 2006).

⁶¹⁸ The Deferred Retirement Option Program, or “DROP,” allows an employee to begin receiving his or her pension payments, which are invested in a separate interest-earning account, while he or she continues to work for up to five years for the City. Once the employee retires, he or she may take a one-time payout or have the money invested in an annuity for incremental distribution. Jennifer Vigil, *Deputy City Manager Herring Will Retire*, Aug. 5, 2005, San Diego Union-Tribune, available at <http://www.signonsandiego.com/news/metro/pension/20050805-9999-7m5herring.html>.

⁶¹⁹ This is not the only unique benefit of which Mr. Saathoff took advantage. In the spring of 2002, Mr. Saathoff requested three and one-half years of service credit under the PSC program. Despite 18 months passing since Mr. Saathoff's initial request was priced in 2000, SDCERS Administrator Lawrence Grissom permitted him to make the purchase in 2002 at 2000 prices – a savings of about \$9,900 – without the knowledge of the SDCERS Board. By this time, Mr. Saathoff was well aware that PSCs were underpriced and increased the System's unfunded liability. Mr. Saathoff was also aware that the Presidential Leave benefit was part of the ongoing meet and confer negotiations and would enable him to use both his City and union salaries to calculate his retirement benefits, even though his union salary was *not* included in calculating the price of his service credits. Audit Report from Darlene Morrow-Truver, Audit Manager, to Richard Vortmann, Chair, Audit Committee, SDCERS (Feb. 27, 2004); Draft Memorandum from Darlene Morrow-Truver, Audit Manager, to Loraine E. Chapin, General Counsel (Oct. 24, 2003); Letter from Rick A. Roeder to Service Purchase Task Force (Feb. 19, 2002).

The Presidential Leave package was passed by resolution just weeks before the City Council approved the ordinance implementing MP-2,⁶²⁰ and before the SDCERS Board (including Mr. Saathoff himself) gave its final approval to modify the City's contribution rate. The resolution allowed Mr. Saathoff and (in theory) others to combine their City and union salaries to calculate the high one-year salary for purposes of calculating their pension benefits.⁶²¹ Although the MP-2 ordinance was first introduced on the same day the Presidential Leave resolution was adopted, conspicuously, Presidential Leave was addressed separately than MP-2 and by a different vehicle, a resolution.⁶²² By approving the benefit by resolution (rather than ordinance) the City Council did not need to consider it twice as it otherwise would have (guaranteeing Mr. Saathoff his benefit well in advance of when his Board vote on MP-2 took place), and the benefit was implemented without a vote by the SDCERS membership.⁶²³ The timing and manner in which Mr. Saathoff received this benefit further suggests a level of intentional and willful misconduct by Mr. Saathoff surpassing that of the other non-City representatives on the Board.⁶²⁴ In participating in the shaping of MP-2 while simultaneously benefiting substantially from its approval, Mr. Saathoff acted with wrongful intent.

⁶²⁰ San Diego City Council Resolution 297212 (Oct. 21, 2002); San Diego, Cal., Ordinance O-19121 (Nov. 18, 2002). Moreover, this resolution was passed before Mr. Saathoff and the SDCERS Board gave their final approval of the City contribution agreement aspect of MP-2. Minutes, SDCERS Board Meeting at 29-30 (Nov. 15, 2002).

⁶²¹ San Diego City Council Resolution 297212 (Oct. 21, 2002). In practice, this resolution only benefited Mr. Saathoff, as he was the only union president who actually received a City salary in addition to his union salary. E-mail from Judy Zellers to Lawrence Grissom cc to Cathy Lexin and Terri Webster (Sept. 20, 2001).

⁶²² Minutes, San Diego City Council Meeting at 9-11, 30-31 (Oct. 21, 2002).

⁶²³ The San Diego City Charter requires that most types of ordinances (including the MP-2 ordinance at issue) must be introduced at a Council meeting at least twelve days before they are ultimately approved by Council and must be read in full prior to final passage. San Diego City Charter art. III, § 16. Resolutions, on the other hand, take effect upon passage unless otherwise stated within the resolution. San Diego City Charter art. III, § 17. The Charter also mandates that any ordinance which affects the benefits of any employee or retiree must be approved by a majority vote of the members of SDCERS. San Diego City Charter art. IX, § 143.1. As stated in the MP-2 ordinance and noted at the meeting at which it was introduced, the ordinance could only take effect "upon approval by the Membership of the Retirement System pursuant to Charter Section 143.1." San Diego, Cal., Ordinance O-19121 (Nov. 18, 2002); Minutes, San Diego City Council Meeting at 10 (Oct. 21, 2002).

⁶²⁴ While the Reish Luftman Report refrained from discussing conflict of interest violations, it concluded that Ron Saathoff and Terri Webster breached their fiduciary duties as SDCERS Board members by not informing the other Board members about the benefit enhancements they were receiving through MP-2. Reish Luftman Reicher & Cohen, Legal Analysis of Investigative Report on the San Diego City Employees' Retirement System at 93-94 (Jan. 20, 2006). The City Attorney concluded that Mr. Saathoff (among other City employees on the SDCERS Board) violated conflict of interest provisions and breached his fiduciary duties to SDCERS by approving MP-2. City Attorney Michael J. Aguirre, Interim Report No. 3 Regarding Violations of State and Local Laws as Related to the SDCERS Pension Fund at 14-21 (Apr. 9, 2005). Vinson & Elkins only suggested that Mr. Saathoff and other City employee members of the SDCERS Board may have been induced to approve MP-2 through enhanced benefits and, in doing so, also violated conflict of interest provisions. Paul S. Maco & Richard C. Sauer, Vinson & Elkins LLP, Potential Violations of the Federal Securities Laws by the City of San Diego and Associated Individuals at 60-62, 70-73 (Draft July 15, 2005).

Finally, responsibility for these illegal conflicts must be allocated to the SDCERS Board itself which – apart from the failings of any individual Board member – was plagued by a pervasive lack of structural independence from the City. With three of its 13 members representing the City Manager, Auditor, and Treasurer, and with an additional six chosen from a combination of union representatives, City employees, and retirees – each of whom receives benefits from the system – it was inevitable the City would wield undue influence over the deliberations of the SDCERS Board, especially where enhanced member benefits were at stake.⁶²⁵ Where MP-1 and MP-2 were concerned, the interests of the City in avoiding its payment obligations to SDCERS appear to have taken precedence in the Board’s deliberations, to the detriment of the one entity they were duty-bound to protect – the SDCERS Trust.

2. SDCERS Administrator Lawrence Grissom

If any one person could be said to have “run” SDCERS, that person was Lawrence Grissom. Mr. Grissom was the SDCERS Administrator, a position he had held for many years, and he understood and appreciated the actuarial underpinnings of SDCERS better than anyone else.⁶²⁶ Based on his professional background, experience, and responsibilities, Mr. Grissom could have and should have prevented many of the actions taken by the Board that breached the Board’s fiduciary duty or posed an unacceptable risk to the health of SDCERS. Mr. Grissom failed to fulfill his professional obligations to the plan participants whose retirement security he was entrusted to administer.⁶²⁷

⁶²⁵ San Diego City Charter art. IX, § 144 (amended Nov. 2, 2004); San Diego City Charter art. X, § 1 (amended Nov. 2, 2004). As of April 1, 2005, the composition of the Board changed to include seven independent members and six members required to be chosen from a combination of union representatives, City employees (including one City Manager Designee), and retirees. San Diego City Charter art. IX, § 144.

⁶²⁶ Minutes, SDCERS Board Meeting at 1, 7 (May 20, 2005); Memorandum from Lawrence B. Grissom, Retirement Administrator, to Bruce Herring, Deputy City Manager (July 1, 2002); Memorandum from Lawrence B. Grissom, Retirement Administrator, to Retirement Board, via Business Procedures Committee (Mar. 6, 2001); Memorandum from Lawrence B. Grissom, Administrator, to Retirement Board (June 18, 1996); Memorandum from Lawrence B. Grissom, Administrator, to Retirement Board of Administration (June 12, 1996); Minutes, SDCERS Board Meeting at 1, 31 (May 19, 1995).

⁶²⁷ The City Attorney alleged that Mr. Grissom violated fiduciary duties owed to the SDCERS members by participating in and influencing the decisions to implement MP-1 and MP-2 because he received special compensation not given to others in his position. Second Amended Complaint, *People v. Grissom*, No. GIC 850246, at 11-12 (Cal. Super. Ct. Dec. 12, 2005). However, in a related action, the court held that Mr. Grissom could only be liable for conspiring to breach a Board member’s fiduciary duty, since art. 15, § 17 establishes a fiduciary relationship between Board members and beneficiaries only, not SDCERS employees and beneficiaries. Order, *San Diego City Employees’ Ret. Sys. v. Aguirre*, No. GIC 841845, at 9 (Cal. Super. Ct. Sept. 26, 2005). Notably, in Interim Report No. 6 issued earlier in 2005, the City Attorney had concluded that Mr. Grissom did owe a fiduciary duty to SDCERS members and violated that duty by allowing the City to stray from its actuarially calculated contributions to the plan, though the City Attorney did not provide a legal basis for a pension plan administrator’s fiduciary relationship to plan participants. City Attorney Michael J. Aguirre, Amended Interim Report No. 6 Regarding the San Diego City Employees’ Retirement System Funding Scheme at 33 (July 1, 2005). The legal analysis accompanying the Navigant Report discussed the possibility that Mr. Grissom owed an affirmative duty under California employment law to voice concerns about potential wrongdoing of the Board, but largely concluded that such a duty does not exist. Reish Luftman Reicher & Cohen, Legal Analysis of Investigative Report on the San Diego City Employees’ Retirement System at 119 (Jan. 20, 2006).

With respect to MP-1, it was Mr. Grissom who served as the “client” in dealings with the Board’s advisors, including its actuary and fiduciary counsel.⁶²⁸ Insofar as the Board failed to seek appropriate legal advice, or acted on poorly understood actuarial recommendations, Mr. Grissom bears responsibility for failing to supervise properly the Board’s professional advisors. Moreover, among the Board’s professional staff, Mr. Grissom best understood that the concept of Surplus Earnings, the linchpin of MP-1, was premised upon a fundamental misconception.⁶²⁹ Mr. Grissom knew SDCERS’s earnings in excess of 8% were not truly “surplus” because SDCERS needed to keep those assets within the system to make up for years in which investment returns fell short of the actuarially determined 8% return.⁶³⁰ Notwithstanding this knowledge, Mr. Grissom facilitated the Board’s decision to adopt MP-1, putting, as the Board did, the City’s interest in avoiding actuarially determined contributions over and above the interests of SDCERS. If anyone should have kept the Board “honest” with respect to MP-1, it was Mr. Grissom. He failed in this responsibility.

Worse yet, after MP-1 had been approved, Mr. Grissom adopted the City’s goal of limiting disclosure about the extent of the underfunding that MP-1 created. The City resisted reporting any NPO at all, based on the fundamentally flawed argument that the NPO was “funded in a reserve.” Mr. Grissom not only supported this position himself, he went so far as to suggest that SDCERS consider changing actuaries because Mr. Roeder was resistant to the argument that there was no need to report an NPO.⁶³¹ When the City did finally report an NPO (reduced by the adoption of a 40-year amortization period), Mr. Grissom helped craft the misleading disclosure that the NPO was “funded in a reserve.”⁶³² To the extent that Mr. Grissom supported the City’s failure to report, and then its under-reporting of, the NPO, he facilitated the City’s violation of its disclosure obligations to the public and SDCERS’s fiduciary obligations to its members.

Mr. Grissom’s actions were even more egregious when it came to MP-2. There, Mr. Grissom did not even believe the proposal was in the best interests of SDCERS. In fact, as he later admitted

⁶²⁸ City Manager, Retirement System Proposal (Consolidated from Proposal Dated June 7, 1996, as Modified by June 21, 1996 Proposal); Memorandum from Lawrence B. Grissom, Administrator, to Retirement Board (June 18, 1996); Memorandum from Lawrence B. Grissom, Administrator, to Retirement Board of Administration (June 12, 1996).

⁶²⁹ Letter from Dwight Alan Hamilton, Hamilton and Faatz, and John A. Graham, Frandzel & Share, to Lawrence B. Grissom, Retirement Administrator (June 21, 1996); Letter from Rick A. Roeder to Larry Grissom (June 13, 1996).

⁶³⁰ Minutes, SDCERS Investment Committee Meeting at 16 (Apr. 18, 2002) (Grissom states the term “surplus earnings” is a misnomer); Minutes, SDCERS Investment Committee Meeting at 4 (Mar. 20, 1997) (Grissom states that surplus is not considered excess earnings until the System’s funding ratio exceeds 100%).

⁶³¹ E-mail from Terri Webster to Lawrence Grissom (July 9, 1999); E-mail from Lawrence Grissom to Terri Webster (Mar. 31, 1998).

⁶³² E-mail from Rick Roeder to Lawrence Grissom and Paul Barnett (Sept. 5, 2003); E-mail from Lawrence Grissom to Terri Webster (Mar. 31, 1998).

to SDCERS's outside counsel, he affirmatively believed that there was "very little justification" for it.⁶³³ Notwithstanding his reservations, Mr. Grissom shepherded the proposal through the Board's deliberative process in a heavy-handed manner that all but guaranteed its adoption. He directed SDCERS's fiduciary counsel, Robert Blum, as to how Mr. Blum's supposedly independent legal advice should come out (at first requesting an opinion disapproving MP-2 and, later, asking Mr. Blum to reverse course and approve the measure).⁶³⁴ He encouraged Mr. Blum to twist the actuary's arm when Mr. Roeder began having second thoughts about releasing a written opinion advising that the five-year phase-in adopted by MP-2 was "reasonable," resulting in an actuary opinion that was confusing if not affirmatively misleading.⁶³⁵ And he instructed Mr. Roeder to cease having "one-on-one" conversations with Board members, after Mr. Roeder had responded to Diann Shipione's inquiries by sharing his concerns about MP-2 with her.⁶³⁶ In actively manipulating the independent assessments of the outside professionals who were charged with providing objective advice about the health of the pension system, Mr. Grissom failed in his responsibility to administer and protect the SDCERS Trust. In so doing, Mr. Grissom acted with wrongful intent.

3. SDCERS General Counsel's Office

In 1997, Loraine Chapin began service as SDCERS General Counsel, filling a role that had previously been handled by the City Attorney's Office.⁶³⁷ Unlike SDCERS Administrator Lawrence Grissom, Ms. Chapin does not appear to have played an active role in shaping and winning approval for MP-1, MP-2 or in any of the disclosure issues arising out of the proposals. Nonetheless, Ms. Chapin failed to adequately perform the critical legal watchdog role assigned to her.

With respect to MP-2 (since Ms. Chapin assumed her position within SDCERS after the adoption of MP-1), the record shows that Ms. Chapin was fully informed of all developments concerning the

⁶³³ E-mail from Lawrence Grissom to Sheila Leone cc to Loraine Chapin, Paul Barnett, and Sheila Jacobs (Sept. 12, 2003). Moreover, Mr. Grissom appears to have understood the potential illegality of City officials on the SDCERS Board having a hand in crafting their own benefits. E-mail from Terri Webster to Lawrence Grissom (May 20, 2002).

⁶³⁴ E-mail from Sheila Leone to Loraine Chapin cc to Roxanne Story Parks (Mar. 24, 2003).

⁶³⁵ Letter from Rick A. Roeder to Larry Grissom, Retirement Administrator (Nov. 5, 2002); E-mail from Lawrence Grissom to Robert Blum (Oct. 30, 2002).

⁶³⁶ See E-mail from Rick Roeder to Lawrence Grissom (Nov. 26, 2002); E-mail from Constance Hiatt to Lawrence Grissom (July 18, 2002).

⁶³⁷ Ms. Chapin had previously counseled the SDCERS Board as a Deputy City Attorney until the official position of SDCERS General Counsel was created within SDCERS in 1997. Agreement for Retirement System Legal Services (Apr. 9, 1997). In her capacity as a Deputy City Attorney, she attended the June 11, 1996, SDCERS Board meeting at which MP-1 was proposed. The minutes reflect her explaining that, based on "her review of this proposal, the only amendment she is aware of that would need to occur would be a City Charter amendment in regards to the health insurance issue." Minutes, SDCERS Board Meeting at 8 (June 11, 1996). From the evidence available to the investigation, it does not appear that Ms. Chapin raised any other concerns about the legality of MP-1.

proposal and its approval by SDCERS.⁶³⁸ First, in her capacity as SDCERS General Counsel, Ms. Chapin was present at the SDCERS Board meeting at which MP-2 was first formally proposed and the two subsequent meetings at which it was discussed and approved.⁶³⁹ Second, Ms. Chapin appreciated the inherent legal problems with simultaneously granting new benefits to SDCERS members and providing contribution relief to the City. In dealing with the task of modifying the Municipal Code to allow for assets in the Employee Contribution Rate reserve to be used to offset benefit increases, Ms. Chapin stated: “This is further support for the propositions that future meet and confer benefits involving retirement not be subject to a contingency such as the Board approving requested funding changes for the System as well as prospective effective dates.”⁶⁴⁰ Third, Ms. Chapin understood the potential for allegations of fiduciary duty breaches by SDCERS Board members, as she worked with SDCERS fiduciary counsel to address the desire of several Board members to secure indemnification by the City in connection with the approval of MP-2.⁶⁴¹

Moreover, Ms. Chapin failed to timely address the conflicts of interest that colored the votes of various SDCERS Board members, most prominently Cathy Lexin, who only recused herself from consideration of the proposal *after* the critical vote approving MP-2 at the July 11, 2002 SDCERS Board meeting.⁶⁴² Ms. Chapin’s failure to address this issue before the July 11, 2002 meeting is particularly glaring

⁶³⁸ E-mail from Robert Blum to Loraine Chapin, Lawrence Grissom and Paul Barnett cc to Constance Hiatt (Oct. 23, 2002); E-mail from Daniel Kelley to Loraine Chapin cc to Lawrence Grissom, Paul Barnett, Roxanne Parks, Michael Rivo and Cathy Lexin (Aug. 22, 2002); E-mail from Loraine Chapin to Leslie Girard cc to Lawrence Grissom, Paul Barnett and Roxanne Parks (Aug. 21, 2002); E-mail from Loraine Chapin to Robert Blum cc to Lawrence Grissom, Paul Barnett, Roxanne Story Parks and Sheila Leone (Aug. 21, 2002); E-mail from Robert Blum to Lawrence Grissom, Paul Barnett and Loraine Chapin cc to Constance M. Hiatt and Marcus Wu (July 30, 2002); E-mail from Lawrence Grissom to Loraine Chapin, Roxanne Story Parks and Constance Hiatt cc to Paul Barnett and Robert Blum (June 26, 2002).

⁶³⁹ Minutes, SDCERS Board Meeting at 1 (June 21, 2002); Minutes, SDCERS Board Meeting at 1 (July 11, 2002); Minutes, SDCERS Board Meeting at 1 (Nov. 15, 2002).

⁶⁴⁰ E-mail from Loraine Chapin to Leslie Girard cc to Lawrence Grissom, Paul Barnett and Roxanne Parks (Aug. 21, 2002). *See also* e-mail from Loraine Chapin to Terri Webster (Oct. 10, 2002) (Chapin states that “this underscores my frustration with the meet and confer process this year as it relates to retirement benefits. It has been a nightmare.”).

⁶⁴¹ E-mail from Robert Blum to Loraine Chapin, Lawrence Grissom and Paul Barnett cc to Constance Hiatt (July 15, 2002); E-mail from Lawrence Grissom to Loraine Chapin, Roxanne Story Parks, and Constance Hiatt cc to Paul Barnett and Robert Blum (June 26, 2002).

⁶⁴² It appears that Ms. Chapin only became sensitive to this conflict of interest issue after SDCERS fiduciary counsel indicated that Ms. Lexin’s position as both negotiator for the City and fiduciary for SDCERS members might implicate legal concerns. E-mail from Robert Blum to Lawrence Grissom, Paul Barnett and Loraine Chapin cc to Constance Hiatt and Marcus Wu (July 30, 2002); E-mail from Loraine Chapin to Robert Blum cc to Lawrence Grissom, Paul Barnett, Roxanne Story Parks and Sheila Leone (Aug. 21, 2002).

This was not the only occasion upon which Ms. Chapin overlooked potential conflict of interest issues. In connection with the 2003 audit of Ron Saathoff’s Presidential Leave benefit, the Audit Division of the Auditor and Comptroller’s Office investigated an administrative glitch that had allowed Mr. Saathoff to purchase service credit in July 2002 at a discounted contract price. Mr. Saathoff had originally filed an application to purchase four years in

considering she had previously authored an opinion while working under former City Attorney John Witt discussing the fiduciary implications of a SDCERS Board member taking an active role in the meet and confer process.⁶⁴³

On the issues of evaluating the legality of MP-2 and the fiduciary obligations of the SDCERS Board, the performance of other legal staff members of SDCERS – in particular, Assistant General Counsel Roxanne Story Parks – was similarly deficient.⁶⁴⁴ Ms. Parks attended each of the critical SDCERS Board meetings at which MP-2 was discussed and approved.⁶⁴⁵ Ms. Parks worked hand-in-hand with Ms. Chapin in drafting the ordinance underlying certain aspects of MP-2 and in working with fiduciary counsel to implement the request of several SDCERS Board members that the Board be indemnified by the City in connection with its approval of MP-2 on November 15, 2002.⁶⁴⁶ While Assistant General Counsel Sheila Leone Jacobs served a similar role as Ms. Parks, it appears from the evidence available that she did not have as active a role as Ms. Parks in drafting the MP-2 ordinance and considering legal issues implicated by MP-2.

2000, but the contract was apparently never processed and delivered to him. Though Mr. Saathoff did not follow up on this error for nearly two years, SDCERS staff allowed him to use the contract price from his original application in 2000 when he reapplied to purchase credit in 2002. E-mail from Paul Barnett to Alex Ruiz, Darlene Morrow-Truver, and Judy Zellers (Oct. 21, 2003). The Audit Division sought to present this matter to the SDCERS Board, bypassing the staff because of the possible conflict of interest surrounding the favorable treatment accorded Mr. Saathoff. Ms. Chapin resisted the efforts of the Audit Division, believing that it was not necessary to modify Mr. Saathoff's purchase contract or bring the matter before the SDCERS Board. Draft Confidential Audit Memo from Darlene Morrow-Truver, Audit Manager, to Loraine E. Chapin, General Counsel (Oct. 24, 2003); E-mail from Judy Zellers to Darlene Morrow-Truver and Kyle Elser (Oct. 21, 2003); Interview by the Audit Committee with Darlene Morrow-Truver (Apr. 26, 2006).

⁶⁴³ Memorandum of Law from City Attorney to Larry B. Grissom, Retirement Administrator (Mar. 10, 1992) (authored by Loraine L. Etherington (Chapin), Deputy City Attorney). In Ms. Chapin's defense, Mr. Blum (SDCERS fiduciary counsel) had weighed in on the issue of SDCERS Board members' conflicts of interest in early July 2002, reasoning that a SDCERS Board member (Tom Rhodes, president of and labor negotiator for the Police Officer's Association) who was involved in the labor negotiations earlier in the year could discharge his fiduciary duties in voting on MP-2 so long as "he/she can vote as a fiduciary and act separately from the role as a negotiator, and actually does this." E-mail from Robert Blum to [Tom Rhodes] cc to Connie M. Hiatt, Loraine Chapin, Lawrence Grissom and Paul Barnett (July 3, 2002). However, as illustrated by Mr. Blum's change of course later in July 2002, Cathy Lexin's involvement in the approval of MP-2 presented a much more substantial conflict than that of Mr. Rhodes, who was not involved in the crafting of the MP-2 agreement as a whole. Similar to Mr. Blum, Ms. Chapin should have been more sensitive to the conflicts surrounding Ms. Lexin before the July 11, 2002 SDCERS Board meeting.

⁶⁴⁴ Besides Ms. Chapin and Ms. Parks, SDCERS internal legal staff consisted only of Assistant General Counsel Sheila Leone Jacobs and several paralegals. Interview by Navigant Consulting with Roxanne Story Parks (Dec. 15, 2005). Ms. Parks and Ms. Leone currently work in the Office of SDCERS General Counsel.

⁶⁴⁵ Minutes, SDCERS Board Meeting at 1 (June 21, 2002); Minutes, SDCERS Board Meeting at 1 (July 11, 2002); Minutes, SDCERS Board Meeting at 1 (Nov. 15, 2002). Ms. Jacobs attended the June 21, 2002 and November 15, 2002 meetings.

⁶⁴⁶ E-mail from Loraine Chapin to Terri Webster (Oct. 10, 2002); E-mail from Loraine Chapin to Robert Blum cc to Lawrence Grissom, Paul Barnett, Roxanne Story Parks and Sheila Leone (Aug. 21, 2002); E-mail from Loraine Chapin to Leslie Girard cc to Lawrence Grissom, Paul Barnett and Roxanne Parks (Aug. 21, 2002); E-mail from Lawrence Grissom to Loraine Chapin, Roxanne Story Parks and Constance Hiatt cc to Paul Barnett and Robert Blum (June 26, 2002).

The Audit Committee requested to speak with Ms. Chapin, Ms. Parks, and Ms. Jacobs about, among other things, the operations of the Office of General Counsel. All three declined to be interviewed.

Apparently, due to conflict of interest concerns (since SDCERS staff members would be affected by the benefit enhancements), Ms. Chapin instructed Ms. Parks and Ms. Jacobs to defer to outside fiduciary counsel in rendering legal advice to the Board in connection with MP-2.⁶⁴⁷ Surprisingly, they were not alarmed after the remarkable turnaround in fiduciary counsel Hanson Bridgett's advice, first cautioning the Board against approving MP-2 and then changing course and issuing an opinion in November 2002 endorsing the proposal as a "reasonable exercise of the Board's fiduciary responsibilities."⁶⁴⁸ Significantly, Ms. Chapin appears to have been involved in the shaping of Hanson Bridgett's second opinion letter in 2002, discussions with the City over certain aspects of MP-2, and was privy to information suggesting that pressure was put on SDCERS actuary Rick Roeder to approve the modified funding mechanism of MP-2.⁶⁴⁹ Though Ms. Chapin may have formally refrained from advising the SDCERS Board as to their fiduciary obligations, she was very much involved in the selling of the proposal to the Board.

Given her participation in the crafting of MP-2 and her awareness of the significant fiduciary issues it raised, Ms. Chapin failed to fulfill her legal duties to SDCERS. To the extent of their respective awareness of the fiduciary concerns surrounding MP-2, Ms. Parks and Ms. Jacobs must also bear some responsibility for failing to act on warning signs of significant legal problems with the proposal.

4. SDCERS Actuary Rick Roeder

Rick Roeder, of Gabriel, Roeder, Smith & Company, was the SDCERS actuary throughout MP-1 and MP-2. When confronted with important decisions, the Board looked to Mr. Roeder for actuarial advice.

Mr. Roeder bears substantial responsibility for the Board's decision to adopt MP-1. Of all of the Board's advisors, Mr. Roeder was the most qualified to understand, and explain to the Board, the basic conceptual mistake supporting the Board's assumption that SDCERS's Surplus Earnings were assets the

⁶⁴⁷ Interview by Navigant Consulting with Roxanne Story Parks (Dec. 15, 2005).

⁶⁴⁸ E-mail from Sheila Leone to Lori Chapin cc to R. Parks (Mar. 24, 2003); Letter from Bob Blum and Connie Hiatt to Frederick Pierce, Retirement Board President (Nov. 18, 2002); Letter from Constance M. Hiatt and Robert Blum to Lawrence Grissom, Retirement Administrator (Draft June 12, 2002). Correspondence between Ms. Parks and Ms. Jacobs regarding the deposition of Robert Blum arising out of SDCERS's lawsuit against Hanson Bridgett for professional malpractice suggests that Ms. Parks and Ms. Jacobs were, at the very least, aware of Mr. Blum's reversal of opinion in 2002. E-mail from Sheila Jacobs to Roxanne Story Parks (Jan 30, 2004); E-mail from Sheila Jacobs to Reg Vitek (Jan. 29, 2004); Interview by Navigant Consulting with Roxanne Story Parks (Dec. 15, 2005).

⁶⁴⁹ E-mail from Robert Blum to Rick Roeder cc to Constance Hiatt, Loraine Chapin, Lawrence Grissom and Paul Barnett (Oct. 29, 2002); E-mail from Lawrence Grissom to Loraine Chapin (Oct. 24, 2002); E-mail from Robert Blum to Lawrence Grissom, Paul Barnett and Loraine Chapin cc to Connie M. Hiatt (Sept. 22, 2002); E-mail from Robert Blum to Loraine Chapin, Lawrence Grissom and Paul Barnett (Sept. 16, 2002).

Board could deplete for any reason it saw fit. However, it does not appear Mr. Roeder properly advised the Board regarding the erroneous assumption at the very foundation of the Surplus Earnings concept, nor did he advise the Board of the fact that, in adopting MP-1, it was putting the soundness of SDCERS at grave risk. Instead, Mr. Roeder fell in line with Mr. Grissom and City representatives on the Board, basing his support on the inclusion of the trigger provision in the proposal.⁶⁵⁰

Mr. Roeder also failed to render competent, clear actuarial advice in connection with MP-2. Unlike MP-1, however, which Mr. Roeder believed could work as long as the City respected the funded ratio “trigger,” Mr. Roeder never believed MP-2 was in the best interests of SDCERS.⁶⁵¹ Notwithstanding this belief, Mr. Roeder allowed himself to be marginalized by SDCERS’s fiduciary counsel, Robert Blum, and others who were advocating for MP-2.⁶⁵² For example, in response to doubts raised by Mr. Roeder over language in his “final” actuarial opinion suggesting that he endorsed MP-2, Mr. Blum cautioned Mr. Roeder that “lots of people would be very unhappy if you are unwilling to sign off on it [the November 5, 2002 actuarial letter] now.”⁶⁵³ After Mr. Roeder backed down, Mr. Blum forwarded the entire e-mail chain

⁶⁵⁰ At the June 11, 1996 SDCERS Board meeting at which MP-1 was proposed, the minutes reflect that Mr. Roeder explained that “he would have been reluctant to recommend this plan without some sunset provisions. However, he stated that he believes that this is a sound proposal as long as the funded ratio does not drop significantly, and with the appropriate sunset provisions in place.” Minutes, SDCERS’ Retirement Board of Administration Special Workshop at 15 (June 11, 1996).

In an action brought by the City Attorney against Gabriel, Roeder, Smith & Co. (“GRS”), among other entities, it is alleged that GRS, but not Mr. Roeder specifically, committed professional negligence by endorsing MP-1 and continually representing that SDCERS was in good financial health between 1997 and 2001. Although the City also claimed that GRS had committed intentional fraud and affirmative misrepresentation and intentional fraud and concealment, it did not allege that Mr. Roeder (or GRS) committed professional malpractice or breached fiduciary duties owed to SDCERS. First Amended Complaint at 11, *City v. Callan Associates, Inc.*, No. GIC 852419 (Cal. Super. Ct. Aug. 15, 2005).

⁶⁵¹ Letter from Rick Roeder to Councilman Scott Peters (Aug. 12, 2004); Letter from Reg A. Vitek, Seltzer Caplan McMahon Vitek, to Sheila Leone, Esq., San Diego City Employees’ Retirement System cc to Michael A. Leone, Esq. (Mar. 5, 2003); Letter from Rick A. Roeder to Larry Grissom, Retirement Administrator (Nov. 5, 2002); E-mail from Constance Hiatt to Lawrence Grissom cc to Robert Blum (July 18, 2002); Presentation, “Analysis of Proposed Change to Manager’s Proposal” (July 11, 2002) (For Mr. Roeder to be satisfied “that the updated manager’s Proposal is financially viable, the City would need to demonstrate that a significantly higher amount of financial resources will be available to be allocated to pension funding and will, in fact, be made.”); Presentation, “Actuarial Information re: Manager’s Proposal” (June 12, 2002); Minutes, SDCERS’ Retirement Board of Administration Special Workshop at 15 (June 11, 1996).

⁶⁵² In the months leading up to MP-2, Mr. Blum, Ms. Chapin, and Mr. Grissom, among others, compromised Mr. Roeder’s independence by, at the very least, seeking to shape the contours of Mr. Roeder’s opinion to meet the demands of the Board and the proposal. E-mail from Robert Blum to Loraine Chapin, Lawrence Grissom, and Paul Barnett cc to Constance Hiatt (Sept. 16, 2002) (“[I] now have a good first draft of the opinion letter in connie’s hands. the key will be what we can get rick to say.”).

⁶⁵³ E-mail from Lawrence Grissom to Robert Blum (Oct. 30, 2002). Later, in connection with Mr. Blum’s November 18, 2002, fiduciary opinion to the SDCERS Board, Mr. Blum vetoed a sentence that Mr. Roeder wanted to include in the opinion warning that MP-2 could result in twelve consecutive years of paying less than the actuarial rate. E-mail from Rick Roeder to Richard C. Sauer (June 21, 2004).

reflecting their communications to Mr. Grissom, noting that “rick will sign,” to which Mr. Grissom replied, “good.”⁶⁵⁴ The exchange is illuminating in that it shows how Mr. Roeder, apparently against his better judgment, was effectively pressured into providing to the SDCERS Board the paper trail it needed to justify MP-2.⁶⁵⁵ Mr. Roeder’s inability to stand up to this pressure is a large part of the reason that SDCERS finds itself in the current financial crisis. The Audit Committee requested to speak with Mr. Roeder regarding, among other things, his working relationship with SDCERS fiduciary counsel and his actuarial opinions. Mr. Roeder declined to be interviewed.

Finally, by repeatedly issuing annual valuation reports blessing SDCERS as actuarially “sound”⁶⁵⁶ – even after the City had adopted a funding program that was, by his own estimation, guaranteed to erode the actuarial soundness of SDCERS⁶⁵⁷ – Mr. Roeder facilitated the perpetuation of the underfunding scheme and breached his professional obligations to the SDCERS Trust.⁶⁵⁸ Time and time again, Mr. Roeder

⁶⁵⁴ E-mail from Lawrence Grissom to Robert Blum (Oct. 30, 2002). Nonetheless, Mr. Roeder’s final opinion, while tepid in its endorsement of MP-2 – noting only that the version as adopted was “reasonable” as compared with what had come before – affirmatively stated that it would be preferable for the Board to leave MP-1 in place. Letter from Rick A. Roeder to Larry Grissom, Retirement Board Administrator (Nov. 5, 2002); Letter from Reg A. Vitek, Seltzer Caplan McMahon Vitek, to Sheila Leone, Esq., SDCERS, cc to Michael A. Leone, Esq. (Mar. 5, 2003).

⁶⁵⁵ In a lawsuit brought by three individual members of SDCERS against Mr. Roeder and his actuarial firm, Gabriel, Roeder, Smith & Company (“GRS”), the plaintiffs alleged that Mr. Roeder and GRS committed fraud by concealment and negligence by concealing or failing to disclose that MP-2 would render the City’s pension fund actuarially unsound. Complaint, *Gleason v. Gabriel, Roeder, Smith & Co.*, No. GIC 849882, at 3 (Cal. Super. Ct. June 28, 2005). In a partial dismissal, the allegations against Mr. Roeder, individually, were dismissed without prejudice by the Court. Dismissal Entered on March 7, 2006, *Gleason v. Gabriel, Roeder, Smith & Co.*, No. GIC 849882 (Cal. Super. Ct. Mar. 7, 2006).

⁶⁵⁶ Gabriel, Roeder, Smith & Co., San Diego City Employees’ Retirement System Annual Actuarial Valuation June 30, 2001, at 17 (Feb. 12, 2002); Gabriel, Roeder, Smith & Co., San Diego City Employees’ Retirement System Annual Actuarial Valuation June 30, 2000, at 19 (Mar. 8, 2001); Gabriel, Roeder, Smith & Co., San Diego City Employees’ Retirement System Annual Actuarial Valuation June 30, 1999, at 17 (Feb. 14, 2000); Gabriel, Roeder, Smith & Co., San Diego City Employees’ Retirement System Annual Actuarial Valuation June 30, 1998, at 18 (May 5, 1999); Gabriel, Roeder, Smith & Co., San Diego City Employees’ Retirement System Annual Actuarial Valuation June 30, 1997, at 17 (Jan. 16, 1998); Gabriel, Roeder, Smith & Co., San Diego City Employees’ Retirement System Annual Actuarial Valuation June 30, 1996, at 19 (Jan. 9, 1997); Gabriel, Roeder, Smith & Co., San Diego City Employees’ Retirement System Annual Actuarial Valuation June 30, 1995, at 16 (Jan. 19, 1996).

⁶⁵⁷ Minutes, SDCERS Board Meeting at 16 (June 11, 1996) (Mr. Roeder stated that under the Proposal “some of these costs will be borne by the future generation.”).

⁶⁵⁸ The Actuarial Standards Board Code of Professional Conduct requires an actuary to perform his duties with integrity, competence, skill, and care. Actuarial Standards Board, Code of Prof’l Conduct, Precept 1, Annotation 1-1 (2001). Additionally, actuaries must take reasonable steps to ensure that their services are not used to mislead others. Actuarial Standards Board, Code of Prof’l Conduct, Precept 8 (2001). The actuary must present information in a manner that is clear, because of the risk that misinterpretations may influence the actions of third parties. Actuarial Standards Board, Code of Prof’l Conduct, Precept 8, Annotation 8-1 (2001).

failed to provide the objective, critical advice that could have protected the SDCERS Trust from the City's penchant for seeking to minimize its contributions to the System.⁶⁵⁹

5. SDCERS's Fiduciary Counsel

In connection with MP-1 and MP-2, the Board received advice from its fiduciary counsel that, ultimately, sanctioned both proposals.⁶⁶⁰ Both times, the Board was poorly served by its counsel.

Fiduciary counsel Dwight Hamilton of the law firm Hamilton and Faatz at first opposed MP-1, raising a number of "red flags" and opining that an agreement to freeze contribution rates would breach the Board's fiduciary duty by tying its hands when changes in actuarial assumptions and financial circumstances otherwise demanded an increase in the City's contribution rates.⁶⁶¹ In particular, Mr. Hamilton was concerned that the SDCERS actuary would not be permitted to alter the actuarial assumptions underlying the System until, at the earliest, 2007.⁶⁶² Mr. Hamilton later changed his opinion after MP-1 was modified to allow, among other things, the actuary to annually review and change actuarial assumptions that, in turn, *could* require the City to increase its contribution schedule such that the City's annual contribution would reach the full EAN rate by July 1, 2009.⁶⁶³ Notably, this revision did not correct the fundamental flaw first perceived by Mr. Hamilton – the City would be allowed to make annual contributions to the System at a rate lower than that calculated by the actuary. Even in signing off on MP-1, Mr. Hamilton's opinion was carefully worded to note merely that the Board would be acting within its "discretion" under the California

⁶⁵⁹ With regard to MP-1, the City Attorney reached a similar conclusion: "Mr. Roeder's conduct fell below applicable professional standards, for in providing guidance to the pension board on explaining the actuarial affect [sic] of MP-1 to plan participants and board members, he was acting as a plan fiduciary." City Attorney Michael J. Aguirre, Interim Report No. 6 Regarding the San Diego City Employees' Retirement System Funding Scheme at 34 (June 21, 2005). With regard to Roeder being pressured into approving MP-2, the City Attorney's conclusion was generally consistent with that of the Audit Committee. City Attorney Michael J. Aguirre, Interim Report No. 7 SDCERS Attorney-Client Privilege Documents Released Under Federal Court Order at 9-13 (Dec. 6, 2005). The Reish Luftman Report suggested that Mr. Roeder did not fulfill his duties as SDCERS actuary by definitively warning the Board of the problems with MP-1 and MP-2. Reish Luftman Reicher & Cohen, Legal Analysis of Investigative Report on the San Diego City Employees' Retirement System at 75, 89-90 (Jan. 20, 2006).

⁶⁶⁰ Letter from Bob Blum and Connie Hiatt to Frederick W. Pierce, IV, President, Retirement Board (Nov. 18, 2002); Letter from Dwight Alan Hamilton, Hamilton and Faatz, and John A. Graham, Frandzel & Share, to Lawrence Grissom, Retirement Administrator (June 21, 1996).

⁶⁶¹ Minutes, SDCERS' Retirement Board of Administration Special Workshop at 18-21 (June 11, 1996).

⁶⁶² Minutes, SDCERS' Retirement Board of Administration Special Workshop at 20 (June 11, 1996). The first iteration of MP-1 provided only an "extraordinary circumstances" exception to this constraint on the SDCERS Board's ability to modify the actuarial underpinnings of the System. City Manager, City Employees Retirement System Proposal at 6 (June 7, 1996). Mr. Hamilton's concerns were not assuaged by this provision, however, as he believed the terminology "extraordinary circumstances" was too ambiguous to provide a practical safeguard. Minutes, SDCERS Board Meeting at 20 (June 11, 1996).

⁶⁶³ Letter from Dwight Alan Hamilton, Hamilton and Faatz, and John A. Graham, Frandzel & Share, to Lawrence Grissom, Retirement Administrator (June 21, 1996); City Manager, Retirement System Proposal at 7 (Consolidated from Proposal Dated June 7, 1996, as Modified by June 21, 1996 Proposal).

Constitution if it were to approve MP-1 – demonstrably short of an affirmative statement that MP-1 was in keeping with the Board’s fiduciary duties.⁶⁶⁴

While it is debatable whether the “fix” to MP-1, noted above, was sufficient to address the deficiency noted by Mr. Hamilton, there were more fundamental problems with his advice.⁶⁶⁵ First, he simply failed to address perhaps the biggest failing of MP-1: it was illegal under California law. It is unclear why Mr. Hamilton did not address this issue. Mr. Hamilton should have addressed the legal status of MP-1 under the San Diego City Charter and the California Constitution. Second, although Mr. Hamilton did address – in an opinion issued three months after the SDCERS Board approved MP-1 – the apparent conflict of interest presented by the fact that benefit enhancements that would accrue to Board members personally were conditioned on the Board’s approval of MP-1, his analysis was superficial, noting merely that the drafters of the City Charter had been well aware that Board members would, in many cases, be members of SDCERS and therefore could be financially interested in the outcomes of the Board’s deliberations.⁶⁶⁶ This analysis, however, failed to fully address the conflict in the context of the unique facts and circumstances of MP-1.

Robert Blum and Constance Hiatt of the law firm Hanson Bridgett served as the Board’s fiduciary counsel with respect to MP-2. If anything, their performance was even worse than Mr. Hamilton’s. They appear to have completely abdicated their responsibility to provide competent, independent legal advice to the Board. In first advising the Board against MP-2 and later in reversing course and advising in favor of it,⁶⁶⁷ it appears Mr. Blum and Ms. Hiatt were taking an inordinate amount of direction from Mr. Grissom.⁶⁶⁸

⁶⁶⁴ Letter from Dwight Alan Hamilton, Hamilton and Faatz, and John A. Graham, Frandzel & Share, to Lawrence Grissom, Retirement Administrator (June 21, 1996).

⁶⁶⁵ The Reish Luftman Report similarly concluded that Mr. Hamilton failed to adequately consider the underlying legality of MP-1. Reish Luftman Reicher & Cohen, Legal Analysis of Investigative Report on the San Diego City Employees’ Retirement System at 73-74 (Jan. 20, 2006). The City Attorney’s criticism of the deficiencies in Mr. Hamilton’s consideration of MP-1 is generally consistent. City Attorney Michael J. Aguirre, Interim Report No. 6 Regarding the San Diego City Employees’ Retirement System Funding Scheme at 41-45 (June 21, 2005). Moreover, the City Attorney found that Mr. Hamilton failed to deliver timely advice to the SDCERS Board about the necessity of examining the City’s ability to report the *de facto* loan SDCERS would be granting it. The City Attorney concluded that Mr. Hamilton’s opinion, delivered three months after the Board approved MP-1, came too late: “The the [sic] board conduct [sic] financial due diligence should have been given *before* the pension board approved MP-1 on 21 June 2002 [sic].” *Id.* at 45 (emphasis in original). Vinson & Elkins suggested that Hamilton’s analysis was incomplete in terms of its analysis of the potential conflicts of interest raised by MP-1. Paul S. Maco & Richard C. Sauer, Vinson & Elkins LLP, Report on Investigation, The City of San Diego, California’s Disclosures of Obligation to Fund the San Diego Employees’ Retirement System and Related Disclosure Practices 1996–2004 with Recommended Procedures and Changes to the Municipal Code at 51 (Sept. 16, 2004).

⁶⁶⁶ Letter from Dwight Alan Hamilton, Hamilton and Faatz, and John A. Graham, Frandzel & Share, to Lawrence Grissom, Retirement Administrator (Sept. 19, 1996).

⁶⁶⁷ Letter from Constance M. Hiatt and Robert Blum to Lawrence Grissom, Retirement Administrator (Draft June 12, 2002); Letter from Bob Blum and Connie Hiatt to Frederick W. Pierce, IV, President, Retirement Board (Nov. 18, 2002).

This is not to say there were not revisions to MP-2 between their first and second opinions – there were. But these revisions did not remedy the basic flaw in MP-2, which was the same as that afflicting MP-1: it was illegal under California law.⁶⁶⁹

Because MP-2 was illegal, and because SDCERS received no benefit from it, the Board could not have approved it without breaching its fiduciary duty to SDCERS.⁶⁷⁰ SDCERS's litigation counsel reached precisely these conclusions in early 2003, after the filing of the *Gleason* litigation.⁶⁷¹ Either Mr. Blum and Ms. Hiatt appreciated the illegality of MP-2 and simply kept silent about it or, inexcusably, failed to understand it. Under either scenario, however, Mr. Blum and Ms. Hiatt's advice was incomplete and inadequate.⁶⁷² While the Audit Committee requested to speak with Mr. Blum and Ms. Hiatt to inquire about, among other things, their understanding of the proposal, they each declined to be interviewed.

⁶⁶⁸ E-mail from Sheila Leone to Lori Chapin cc to Roxanne Parks (Mar. 24, 2003); E-mail from Lawrence Grissom to Robert Blum (Oct. 30, 2002); E-mail from Robert Blum to Loraine Chapin, Lawrence Grissom and Paul Barnett cc to Constance Hiatt (Sept. 16, 2002).

⁶⁶⁹ Rules of Professional Conduct of the State Bar of California, ch. 3, § 3-210 (stating that an attorney has a duty to advise against violations of the law).

⁶⁷⁰ Mr. Blum and Ms. Hiatt also failed to identify timely the potential conflict of interests affecting the votes of the City employees who served on the SDCERS Board. On July 3, 2002, Mr. Blum advised a union representative that had participated in meet and confer earlier in the year that he could discharge his fiduciary duties to SDCERS by voting on MP-2 so long as he made a "thorough, prudent consideration of the facts" of the proposal in his capacity as a SDCERS Board member. E-mail from Robert Blum to [Tom Rhodes] cc to Connie M. Hiatt, Loraine Chapin, Lawrence Grissom and Paul Barnett (July 3, 2002). However, it appears that Mr. Blum did not conduct independent legal research on the issue until the end of August 2002. E-mail from Loraine Chapin to Robert Blum cc to Lawrence Grissom, Paul Barnett, Roxanne Story Parks and Sheila Leone (Aug. 21, 2002). Moreover, Mr. Blum did not raise the issue of conflicts of interest of *City employees* sitting on the SDCERS Board until after the July 11, 2002, SDCERS Board vote approving MP-2 and, even then, he only identified Cathy Lexin as having conflicting interests in connection with the proposal. E-mail from Robert Blum to Lawrence Grissom, Paul Barnett and Loraine Chapin cc to Constance Hiatt and Marcus Wu (July 30, 2002); E-mail from Loraine Chapin to Robert Blum cc to Lawrence Grissom, Paul Barnett, Roxanne Story Parks and Sheila Leone (Aug. 21, 2002). Apparently Mr. Blum only came to appreciate the seriousness of this conflict of interest later, when he wrote in a September e-mail to SDCERS staff that attached a draft of his opinion letter: "PLEASE DO NOT give to Cathy Lexin. cathy [sic] and crew will use it to negotiate and i dont [sic] want them to have that advantage. . . cathy [sic] probably will be all over you on Monday to get a copy. DONT [sic] DO IT." E-mail from Robert Blum to Lawrence Grissom, Paul Barnett and Loraine Chapin cc to Connie M. Hiatt (Sept. 22, 2002).

⁶⁷¹ Letter from Reg A. Vitek, Seltzer Caplan McMahon Vitek, to Sheila Leone, Esq., SDCERS cc to Michael A. Leone, Esq. (Mar. 5, 2003).

⁶⁷² The legal analysis accompanying the Navigant Report concluded that Mr. Blum's final opinion regarding MP-2 failed to consider the legality of the proposal. Reish Luftman Reicher & Cohen, Legal Analysis of Investigative Report on the San Diego City Employees' Retirement System at 90 (Jan. 20, 2006). The City Attorney discussed at length Mr. Blum's involvement in the negotiation and approval process of MP-2, but did not reach any conclusions regarding his personal responsibility. City Attorney Michael J. Aguirre, Interim Report No. 7 SDCERS Attorney-Client Privilege Documents Released Under Federal Court Order at 9-13, 21-22 (Dec. 6, 2005).

B. The City

1. The City Council

As the legislative branch of the City government, the City Council was a key party in the enactment of MP-1 and MP-2. In 1996 and again in 2002, the City Council voted to approve pension funding arrangements that violated the California Constitution, the City Charter, and the Municipal Code.⁶⁷³ Despite the plain language of the controlling statutes, and their obligation as elected officials to uphold the laws of the City and State,⁶⁷⁴ there is no evidence the Council members ever bothered to inquire whether these agreements were permissible under California law.

It should be noted that the Council members who voted on MP-2 had inherited an already violative system and both they and the predecessor Council that adopted MP-1 were failed by their legal counsel – the City Attorney’s Office and outside fiduciary counsel – who did not bring the issue of the legality of these proposals to the Council’s attention. This does not change the central fact, however, that the Council’s vote in approving both MP-1 and MP-2 resulted in an illegally funded pension system.

2. City Administration

The City and its various offices and employees also bear responsibility for illegalities in connection with the City’s pension funding. First, to the extent that the SDCERS Board violated its responsibilities to its members by approving MP-1 and MP-2, overruling Mr. Rick Roeder on the suggested actuarial treatment of the *Corbett* settlement, and allowing the retirement system to become actuarially unsound, the City is responsible for its active encouragement of these unsound practices in order to obtain short-term contribution relief. Second, to the extent the financial condition of the retirement system created reporting obligations for the City, the City is responsible for its failures to satisfy these disclosure requirements.

In the case of MP-1, the relevant City personnel who encouraged the SDCERS Board’s breach of fiduciary duty and contributed toward the City’s violation of the California Constitution, the City Charter, and the Municipal Code include City Manager McGrory, City Auditor Ryan, and the City representatives on the SDCERS Board: Terri Webster, Sharon Wilkinson, and Bruce Herring. City Manager

⁶⁷³ San Diego City Council Ordinance O-19121 (Nov. 18, 2002); San Diego, Cal., Ordinance O-18383 (Feb. 25, 1997); *Gai v. Fresno City Council*, 63 Cal. App. 3d 381, 387 (1976) (“[C]ity charters pertaining to municipal affairs supersede all laws inconsistent therewith.”); *Acton v. Henderson*, 150 Cal. App. 2d 1, 13 (1957) (“We start with the premise that the ordinances . . . of the Municipal Code are invalid if they conflict with the charter . . . section 6 of article XI of the state Constitution so provide[s], and the cases are in accord.”).

⁶⁷⁴ Cal. Const. arts. XX, § 3; San Diego City Charter art. XIV, § 211.

Jack McGrory pressed the SDCERS Board for contribution relief as early as 1994.⁶⁷⁵ He developed the concept that became MP-1 in early 1996,⁶⁷⁶ made the original presentation of MP-1 to the SDCERS Board,⁶⁷⁷ then presented and defended the final version.⁶⁷⁸ At the same time that he was pushing through his agenda at SDCERS for contribution relief for the City, he was spearheading the meet and confer process and keeping the Mayor and Council informed of the progress.⁶⁷⁹ Notably, Mr. McGrory knew of both SDCERS's actuary's and outside fiduciary counsel's concerns about MP-1, namely that the proposal would shift current pension costs onto future taxpayers.⁶⁸⁰ Mr. McGrory nonetheless advocated for MP-1's adoption.⁶⁸¹

City Auditor Ed Ryan, while still a member of the SDCERS Board in 1995, advocated for and voted in favor of one-time contribution relief for the City without even waiting for an opinion on the appropriateness of this relief from fiduciary counsel.⁶⁸² Fiduciary counsel ultimately objected to this proposal for contribution relief and it was never adopted.⁶⁸³ Despite the knowledge that SDCERS's fiduciary counsel

⁶⁷⁵ Memorandum from Jack McGrory, City Manager, to City Employees Retirement System Board of Directors via Larry Grissom, Retirement Administrator (Feb. 17, 1994); Memorandum from Lawrence B. Grissom, Retirement Administrator, to Business and Procedures Committee (May 6, 1994).

⁶⁷⁶ E-mail from Jack McGrory to Distribution (Feb. 29, 1996); Memorandum from Larry Grissom to Keith Enerson (Draft Mar. 1, 1996).

⁶⁷⁷ Minutes, SDCERS Board Meeting at 1 (May 2, 1996).

⁶⁷⁸ Minutes, SDCERS Board Meeting at 12-31 (June 21, 1996).

⁶⁷⁹ Memorandum from Jack McGrory, City Manager, to Honorable Mayor and City Council (June 6, 1996); Memorandum from Jack McGrory, City Manager, to Honorable Mayor and City Council (May 15, 1996).

⁶⁸⁰ Minutes, SDCERS' Retirement Board of Administration Special Workshop at 16, 22 (June 11, 1996).

⁶⁸¹ According to Robert Scannell, Board Member, he received a call from Mr. McGrory's office to lobby Mr. Scannell to vote in favor of MP-1. Interview by the Audit Committee with Robert Scannell (May 3, 2006). *See also* Interview by the Audit Committee with Conny M. Jamison (May 9, 2006).

In his interview with the Audit Committee, Mr. McGrory described what he believed to be two safeguards built into MP-1. First, he said a reserve was established out of surplus earnings at the time MP-1 was adopted, which reserve was intended to cover the shortfall created by the City's reduced contributions. However, since the "reserve" by definition consisted of the retirement system's own assets, establishing it did not offset or protect against the City underfunding the retirement system. Second, Mr. McGrory described that, in his view, it had always been contemplated that if the City were to increase benefits during the term of MP-1, the City would nonetheless be obligated to increase its contributions to cover those new benefits. Whether or not Mr. McGrory or anyone else actually ever held this belief, the MP-1 agreement does not contain such a requirement and in fact, when new benefits were eventually granted, the City's contributions were not revised upward. Interview by the Audit Committee with Jack McGrory (May 4, 2006).

⁶⁸² Minutes, SDCERS Special Board Meeting at 10 (Mar. 24, 1995); Minutes, SDCERS Board Meeting at 9 (Feb. 24, 1995).

⁶⁸³ Letter from Morrison & Foerster to Lawrence B. Grissom, Retirement Administrator (May 9, 1995).

rejected a contribution relief proposal just one year earlier, Mr. Ryan was aware of and made no objection to the adoption of MP-1 which granted the City even greater relief at SDCERS's expense.⁶⁸⁴

Finally, the City representatives to the SDCERS Board who voted to approve MP-1 – Ms. Webster, Ms. Wilkinson, and Mr. Herring, Mr. McGrory's right-hand man⁶⁸⁵ – plainly allowed their loyalties to the City to trump their fiduciary obligations to SDCERS members.⁶⁸⁶

Immediately after the adoption of MP-1, SDCERS and the City were both required to report that the funding mechanism for SDCERS was not approved by the Governmental Accounting Standards Board ("GASB") and to calculate and report, as an NPO, the difference between the payments that the City actually made and the Annual Required Contribution required under a GASB-approved actuarial method.⁶⁸⁷ Nevertheless, this obligation was ignored for more than two years.⁶⁸⁸

A second and more serious accounting issue arose in connection with the 2000 settlement of the *Corbett* litigation. Much of the City's payment obligation under this settlement was structured to be "contingent" on the availability of adequate Surplus Earnings, even though the settlement amounts remained absolute obligations whether or not Surplus Earnings were available. The SDCERS Board, despite concern expressed by the actuary Mr. Roeder, voted *not* to include these "contingent" payments in the pension fund's UAAL.⁶⁸⁹ This actuarial treatment had a material negative impact on the financial soundness of the retirement system, because it allowed the system to record a lower UAAL and, accordingly, a higher funded ratio.⁶⁹⁰ By so doing, it artificially delayed the point at which the system's funded ratio would fall below the

⁶⁸⁴ E-mail from Terri Webster to Jack McGrory (June 21, 1996); Handwritten Notes (May 19, 1996).

⁶⁸⁵ While the SDCERS Board was awaiting fiduciary counsel's opinion on one time rate relief in 1995, Mr. Herring wrote to Mr. Grissom, expressing his concern at the delay in receiving the opinion, due to the proposal's "tremendous financial impact of this action so late in the fiscal year." Memorandum from Bruce Herring, Deputy City Manager, to Larry Grissom, Retirement Administrator (Apr. 6, 1995).

⁶⁸⁶ Minutes, SDCERS Board Meeting at 31 (June 21, 1996).

⁶⁸⁷ Governmental Accounting and Financial Reporting Standards, Vol. II, GASB 27 ¶ 20(b)(3) (June 30, 2005).

⁶⁸⁸ When they began to comply with the reporting requirement, they adopted a 40-year amortization period, rather than the normal 30-year period, for the retirement system's UAAL. While not technically violative of GASB, it was certainly not prudent for the City to adopt an amortization period for purposes of diminishing the value of the reported NPO. The evidence shows that both City Auditor Ryan Ed and Deputy Auditor Terri Webster were actively involved in choosing the 40-year amortization period, which benefited the City at the retirement system's expense. E-mail from Paul Webber to Terri Webster, Ed Ryan and Daniel M. Deaton cc to Paul Webber and Darlene Morrow-Truver (Dec. 24, 2003); E-mail from Terri Webster to Rick Roeder and Darlene Morrow-Truver (Oct. 8, 2003).

⁶⁸⁹ Order and Judgment Approving Settlement of Class Action, *Corbett v. City Employees' Retirement System*, No. 722449, at 9 (Cal. Super. Ct. Apr. 4, 2000); Minutes, SDCERS Board Meeting at 13 (June 21, 2002).

⁶⁹⁰ Minutes, SDCERS Board Meeting at 19 (Feb. 15, 2002); Letter from Rick A. Roeder to Larry Grissom (Mar. 30, 2000).

82.3% trigger and require increased contributions from the City. The retirement system's loss, of course, was the City's gain: the improper treatment of *Corbett* "contingent" liabilities allowed the City, again, to postpone the point at which it would begin to increase its annual payments to SDCERS.

The evidence shows that Ed Ryan, Terri Webster, Lawrence Grissom, Dan Kelley, and Bruce Herring were involved in developing the idea of structuring the *Corbett* settlement to allow room for the argument that these new liabilities did not need to be included in the UAAL and then securing the agreement of the SDCERS Board to treat them this way, despite their own actuary's objection.⁶⁹¹ City employees Terri Webster and Cathy Lexin, in their capacity as SDCERS Board members, also supported this treatment which benefited the City at the expense of the retirement system's members.⁶⁹²

Finally, MP-2 is another clear example of the SDCERS Board being induced to take action to benefit the City at the expense of the retirement system members to whom the Board owed a fiduciary duty. The main City proponents of MP-2 were City Manager Uberuaga, Deputy City Manager Bruce Herring, and the City representatives on the SDCERS Board who voted to approve it: Terri Webster and Cathy Lexin.⁶⁹³

The City Manager's Office was the primary architect and advocate of the MP-2 underfunding proposal. City Manager Uberuaga discussed the concept of MP-2 with the SDCERS Board in May 2002,⁶⁹⁴ then submitted two memoranda explaining the proposal in June.⁶⁹⁵ Deputy City Manager Bruce Herring made presentations to the SDCERS Board advocating MP-2 in June and July,⁶⁹⁶ and, through

⁶⁹¹ Memorandum from Bruce A. Herring, Deputy City Manager, to Honorable Mayor and Councilmembers (Apr. 13, 2000); Memorandum from City Auditor and Comptroller to Honorable Mayor and City Council cc to Michael Uberuaga, City Manager, and Bruce Herring, Deputy City Manager (Apr. 11, 2000); E-mail from Terri Webster to Bruce Herring cc to Dan Kelley and Ed Ryan (Apr. 6, 2000); Letter from Rick A. Roeder to Larry Grissom (Mar. 30, 2000); Handwritten Notes of Cathy Lexin (Feb. 8, 2000).

⁶⁹² Minutes, SDCERS Board Meeting at 11 (June 21, 2002); Minutes, SDCERS Business Procedures Committee Meeting at 6 (Feb. 15, 2002); Minutes, SDCERS Business Procedures Committee Meeting at 4 (Mar. 16, 2001).

⁶⁹³ Minutes, SDCERS Board Meeting at 38 (July 11, 2002); Minutes, SDCERS Board Meeting at 30 (Nov. 15, 2002). Only after the critical vote approving MP-2 in July, Cathy Lexin acknowledged that she faced a potential conflict of interest and recused herself from the November vote.

⁶⁹⁴ Minutes, SDCERS Special Board Meeting at 35-37 (May 29, 2002).

⁶⁹⁵ Memorandum from Michael T. Uberuaga, City Manager, to San Diego City Employees' Retirement System (SDCERS) Board of Administration via Lawrence B. Grissom, Retirement Administrator (June 10, 2002); Memorandum from Michael T. Uberuaga, City Manager, to San Diego City Employees' Retirement System (SDCERS) Board of Administration via Lawrence B. Grissom, Retirement Administrator (June 18, 2002).

⁶⁹⁶ Minutes, SDCERS Board Meeting at 16 (June 21, 2002); Minutes, SDCERS Board Meeting at 2 (July 11, 2002).

memoranda he authored and submitted to the Board, attempted to allay the concerns expressed about the proposal.⁶⁹⁷

Like City Manager McGrory before him, City Manager Uberuaga, as the chief administrative officer of the City, was responsible to the citizens of San Diego to perform diligently and competently in that office, and to supervise adequately the employees working beneath him. In advocating the intentional underfunding of the pension system through MP-1 and MP-2, City Managers McGrory and Uberuaga failed to act in the best interests of the City and did not meet the standards expected of public servants.

The record shows that Ms. Webster and Ms. Lexin, through information they received both as City employees and as members of the SDCERS Board, were keenly aware of the financial implications to the City if the MP-1 trigger were to be breached and of the critical role played by MP-2 in either forestalling this event (the original version of MP-2 would have reduced the funded ratio trigger to 75%) or mitigating its impact.⁶⁹⁸ Indeed, in January 2002, Terri Webster sent an e-mail to Ed Ryan, which stated that the sharp decline in SDCERS investment earnings raised “SERIOUS consequences and needs attention” and needed to be discussed by Ms. Lexin in a briefing with Mr. Grissom.⁶⁹⁹ Ms. Webster, one month later, asked Ms. Vattimo to direct Mr. Roeder to estimate the funded ratio, warning that “[t]he 82% trigger point is looking WAY too close.”⁷⁰⁰ Despite this knowledge, they voted, as SDCERS trustees, to approve MP-2.⁷⁰¹

Securing the SDCERS Board’s approval of MP-2 required not merely the application of general political pressure, but also, in the case of Firefighters Union President and SDCERS Board member Ronald Saathoff, the specific financial inducement of a Presidential Leave benefit that increased his pension in a single stroke by approximately \$30,000 per year.⁷⁰² The evidence shows that City officials Terri Webster,

⁶⁹⁷ Memorandum from Bruce Herring, Deputy City Manager, to Lawrence B. Grissom, Retirement Administrator (July 1, 2002); Memorandum from Bruce Herring, Deputy City Manager, to Lawrence B. Grissom, Retirement Administrator (July 3, 2002).

⁶⁹⁸ E-mail from Terri Webster to Elmer Heap and Michael Rivo cc to Cathy Lexin (Apr. 17, 2002); E-mail from Byron Wear to Cathy Lexin, Brian Maienschein, Donna Frye, George Stevens, Jim Madaffer, Ralph Inzunza, Scott Peters, Councilmember Atkins, and Dick Murphy (June 23, 2002); Minutes, SDCERS Special Board Meeting (May 29, 2002); Minutes, SDCERS Board Meeting (June 21, 2002); Minutes, SDCERS Board Meeting (July 11, 2002); Minutes, SDCERS Board Meeting (Nov. 15, 2002).

⁶⁹⁹ E-mail from Terri Webster to Ed Ryan (Jan. 3, 2002).

⁷⁰⁰ E-mail from Terri Webster to Mary Vattimo (Feb. 12, 2002).

⁷⁰¹ Minutes, SDCERS Board Meeting at 38 (July 11, 2002); Minutes, SDCERS Board Meeting at 30 (Nov. 15, 2002).

⁷⁰² Declaration of San Diego Labor Relations Manager Scott Chadwick in Support of Defendants’ and Cross-Complainants’ San Diego City Attorney Michael J. Aguirre and the City of San Diego’s Motion for Summary Judgment or in the Alternative Motion for Summary Adjudication at 2, 7, *San Diego City Employees’ Ret. Sys. v. Aguirre*, No. GIC 841845 (Cal. Super. Ct. Mar. 15, 2006) (stating that Mr. Saathoff’s retirement benefit increased by \$2,531.00 per month as a result of the implementation of the Presidential Leave benefit in 2002); San Diego City

Ed Ryan, Cathy Lexin, and Dan Kelley and SDCERS Administrator Lawrence Grissom were involved in proposing and obtaining this special benefit for Mr. Saathoff, in apparent exchange for his support for MP-2.⁷⁰³

An individual aids and abets a breach of fiduciary duty if he “(a) knows the other’s conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other to so act or (b) gives substantial assistance to the other in accomplishing a tortious result and the person’s own conduct, separately considered, constitutes a breach of duty to the third person.”⁷⁰⁴ City officials and employees, through their actions regarding MP-1, *Corbett*, and MP-2, applied a tremendous amount of pressure on fiduciaries, demonstrating a severe lack of judgment and a desire to seek a quick fix at the expense of the long-term welfare of SDCERS. However, this conduct alone is insufficient to satisfy the legal standard of aiding and abetting. While there is an abundance of evidence that City officials “substantially assisted” SDCERS Board members in breaching their fiduciary duty to plan participants, there is no evidence that these officials and employees either knew they caused others to breach their duties, or that their own conduct constituted a separate breach of a legal duty.⁷⁰⁵ While City officials clearly acted improperly in both causing the City to

Council Resolution No. R-297212 (Oct. 21, 2002); E-mail from Terri Webster to Mike McGhee (May 21, 2002); Memorandum on Local 145 High One Year Calculation (Nov. 5, 2001); E-mail from Judy Zellers to Larry Grissom cc to Cathy Lexin and Terri Webster with attached Presidential Leave calculation (Sept. 20, 2001).

⁷⁰³ E-mail from Dan Kelley to Ron Saathoff, jeffhoffa@aol.com, IMM@sandiego.gov (July 30, 2002); E-mail from Cathy Lexin to Larry Grissom (June 25, 2002); Memorandum from Cathy Lexin, Human Resources Director, and Elmer Heap, Head Deputy City Attorney, to Honorable Mayor and City Council (June 13, 2002); E-mail from Terri Webster to Mike McGhee (May 21, 2002); Memorandum from Cathy Lexin, Human Resources Director, to Honorable Mayor and City Council (Nov. 26, 2001).

⁷⁰⁴ *Casey v. U.S. Bank Nat’l Ass’n*, 127 Cal. App. 4th 1138, 1144-45 (2005). The City Attorney did not address the legal standard for aiding and abetting a breach of another’s fiduciary duty, but otherwise concluded that, in connection with MP-1, a number of City officials—most notably, City Manager Jack McGrory—breached fiduciary duties owed directly to plan participants. The City Attorney alternatively concluded that even if City officials did not owe plan participants fiduciary duties, those officials arguably triggered such fiduciary obligations by making representations about the appropriateness of the changes to MP-1. City Attorney Michael J. Aguirre, Amended Interim Report No. 6 Regarding the San Diego City Employees’ Retirement System Funding Scheme at 17-18, 20-21 (July 1, 2005). The City Attorney’s conclusions, however, were based on analogy to ERISA case law which held that an employer was a fiduciary under ERISA where it also acted as an administrator, and where the plan documents did not specify a different administrator. *Kendal Corp. v. Inter-County Hospitalization Plan, Inc.*, 771 F. Supp. 681 (E.D. Pa. 1991). This is in contrast to the situation here, where City officials were not acting as administrators of the retirement system and the City Charter expressly provided that the SDCERS Board has *sole* administrative responsibility for SDCERS. Furthermore, ERISA, by its own terms, is explicitly not binding on public retirement systems. 29 U.S.C. § 1003(b)(1) (West 2006). Vinson & Elkins did not specifically address the issue of City officials’ potential responsibility for inducement of the Board’s breach of its fiduciary duties by entering into MP-1 and MP-2.

⁷⁰⁵ While City officials and employees have general responsibilities to the public, they do not have a specific and independent fiduciary responsibility to plan participants, as does the SDCERS Board. *Clark v. City of Hermosa Beach*, 48 Cal. App. 4th 1152, 1170 (Cal. Ct. App. 1996) (stating that this duty requires public officials to exercise their powers with “disinterested skill, zeal, and diligence and primarily for the benefit of the public.”).

adopt an illegal funding scheme and influencing others to breach their fiduciary duties, there is insufficient evidence that they did so knowingly or that their conduct was itself a separate breach of duty.⁷⁰⁶

3. City Attorney's Office

As with SDCERS General Counsel Lori Chapin, the City Attorney's Office was not actively involved in promoting violations of law or duty in connection with MP-1 and MP-2 but failed, in its watchdog role, to identify and prevent these violations.

As we have seen, City Attorney John Witt recused himself from considering MP-1, citing a potential conflict of interest because he would personally benefit from MP-1 when he retired, as planned in the near future.⁷⁰⁷ Mr. Witt noted that MP-1 raised "important fiduciary considerations which must be fully examined."⁷⁰⁸ Whether or not it was appropriate for Mr. Witt to recuse himself, it remained the responsibility of the City Attorney's Office, either directly or through a legal analysis commissioned from an outside law firm, to fully explore both the "fiduciary concerns" to which Mr. Witt alluded and the legality of MP-1 under the California Constitution, the City Charter, and the Municipal Code. None of this was done. Nor did Mr. Witt even consider whether the potential conflict that led to his own recusal would similarly affect the Board members who would, in effect, be voting on their own benefit increases. The City Attorney's Office performed no analysis whatsoever of MP-1, and outside counsel produced only a superficial analysis of the fiduciary obligations of the City and SDCERS Board, without addressing the inherent legality of MP-1 or the conflicts issues it raised.⁷⁰⁹

With respect to MP-2, individuals in the City Attorney's Office were involved with the meet and confer process and the City's proposals to SDCERS. Elmer Heap, Head Deputy City Attorney in the City Attorney's Office, was part of the City's negotiating team in the 2002 meet and confer process,⁷¹⁰ was

⁷⁰⁶ As mentioned at the beginning of this Report, it is worth noting that the focus of the Audit Committee's investigation was not the same as those of the investigations performed by the federal or state prosecutors, who indicted certain individuals on criminal charges. The conclusions reached by this Report are not intended to exonerate any individuals from pending or future prosecutions.

⁷⁰⁷ John W. Witt, City Attorney, Report to the Board of Administration for the San Diego City Employees' Retirement System (Apr. 23, 1996).

⁷⁰⁸ John W. Witt, City Attorney, Report to the Board of Administration for the San Diego City Employees' Retirement System (Apr. 23, 1996).

⁷⁰⁹ Letter from Jeffrey S. Leavitt to Bruce A. Herring, Deputy City Manager (Apr. 29, 1996).

⁷¹⁰ Memorandum from Cathy Lexin, Human Resources Director, and Elmer Heap, Head Deputy City Attorney, to Honorable Mayor and City Council (June 14, 2002); Memorandum from Cathy Lexin, Human Resources Director, and Elmer Heap, Chief Deputy City Attorney, to Mayor and City Council (June 6, 2002).

fully apprised of SDCERS's progress in considering and approving MP-2,⁷¹¹ and negotiated the actual language of MP-2 with SDCERS fiduciary counsel Robert Blum.⁷¹² In addition, Mike Rivo, Deputy City Attorney, was also involved in drafting the agreement between the City and SDCERS, and similarly neglected to advise either party about any potential illegality.⁷¹³ Both Mr. Heap and Mr. Rivo reported to then-City Attorney Casey Gwinn.

Despite the close involvement of the City Attorney's Office in the development and approval of MP-2, no one from that Office at the time appears to have given any consideration to the question of MP-2's legality. No analysis was performed regarding the numerous conflict issues, especially those involving Ronald Saathoff, created by the votes of various SDCERS Board members, the general propriety of linking the City's granting of retirement benefits to SDCERS's acquiescence in direct or indirect contribution relief, or the legality of MP-2 under the California Constitution, the City Charter, or the Municipal Code. One of the principal functions of the City Attorney's Office is to ensure that the City acts at all times in compliance with law. In the case of MP-1 and MP-2, the City Attorney abdicated this responsibility, choosing instead to sit on the sidelines.

⁷¹¹ E-mail from Terri Webster to Ed Ryan and Dan Kelley cc to Bob Lawrence, Bob Wilson, and Elmer Heap (May 21, 2002). Mr. Heap attended the June 21, 2002 SDCERS Board meeting in which a revised MP-2 proposal was discussed. Minutes, SDCERS Board Meeting at 1, 16-32 (June 21, 2002).

⁷¹² E-mail from Robert Blum to Elmer Heap and Mike Rivo (Oct. 16, 2002).

⁷¹³ E-mail from Robert Blum to Elmer Heap and Mike Rivo (Oct. 16, 2002). Mr. Rivo attended the May 29, 2002 SDCERS Board meeting, in which MP-2 was first proposed. Minutes, SDCERS Board Meeting at 1, 35-37 (May 29, 2002).